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The Trust Receipt as Security

by

KARL T. FREDERICK

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School of Business

The Trust Receipt as Security

by

KARL T. FREDERICK

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THE TRUST RECEIPT AS SECURITY

I

In the typical case, the trust receipt comes into existence in the following way: An importer R, for example, who wishes to procure silk from China for manufacture or sale in this country, requests his bank to issue a letter of credit authorizing A B & Company in China to draw their drafts upon the bank for the cost of the silk to be supplied by them. This credit is either delivered to the importer, or sent direct to A B & Company, or transmitted through a second institution located near A B & Company, and, as a condition of its issue, the importer signs an agreement with the bank on the following lines: In consideration of the issue of the credit, the customer agrees to repay to the bank all amounts which may be paid out by it under the credit, together with interest, commissions, etc., and also agrees substantially as follows:

"Your bank shall remain owner of all said merchandise, of all policies of insurance, and of all bills of lading and other documents of title thereto and of the proceeds thereof until the payment as above promised, and also the payment of all other sums that may be or become due by us to your bank. Upon receipt from you of the possession of the said merchandise shipped under such credit, or the

bills of lading or other documents of title thereto, we will sign and deliver a receipt therefor in such form as you may require and will give such security as you may demand, and the said merchandise, after delivery of the custody thereof to us and the proceeds thereof, if sold by us, shall be held subject to your order on demand as your property, with authority to take possession of and dispose of same at any time by public sale or otherwise for your reimbursement or protection, and to charge all expenses, including commissions for sale and guaranty, the bank being free from all responsibility whatever in respect to such sale."

A B & Company then ship the silk in accordance with directions, taking the bill of lading to the order of the bank "notify R." Insurance is also effected, loss, if any, payable to the bank. The seller then draws its draft upon the bank for the cost or purchase price of the shipment, attaches to it the bill of lading, policy of insurance, consular invoice and any other necessary papers, and forwards the draft through banking channels for payment. In many cases, A B & Company, upon exhibiting the letter of credit at their own bank, obtain advances upon or in anticipation of the draft.

The draft in due course is presented to the bank, upon which it was drawn, and is paid. It will be observed, in connection with the foregoing, that title to the silk was not at the outset in the importer and that it has never been transferred to him. Physical possession and control of the silk likewise

have not been his and are not given to him. These are highly important facts in our later discussion.

In due time, the importer is advised of the arrival of the shipment. He goes to the bank, states this fact and expresses a desire that the goods be entered at the customhouse and placed in warehouse. The bank accordingly hands the bill of lading and other shipping documents to him upon his signing a trust receipt [1] for this purpose. The importer has not, up to this time, reimbursed the bank for the amount paid by it upon the draft with agreed commissions and, under the arrangement, it is not contemplated that he shall do so until a later time. If he should do so at once, no occasion for the use of a trust receipt would be presented. It is the intention of the parties, therefore, that the bank shall retain its hold upon the silk as security until such payment is made.

The entry and warehousing of the silk having been accomplished in the name of and as the property of

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[1] This may read as follows: "Property in Trust. Received from the X Bank the merchandise specified in the bill of lading per S. S. Juno, the property of the X Bank, viz., 100 Bales Raw Silk marked A. B., imported under the terms of their letter of credit No. 200, issued for our account, the said bill of lading to be used by us for the sole purpose of entering the above described property at the United States Customs House of the Port of New York, and of immediately storing the same in the name and as the property of the said X Bank, and subject only to their order, we hereby agreeing to so store the said property and to hand the storage receipt for same to the said bank when obtained. We also agree to fully insure said property against fire, the loss, if any, payable to the X Bank, and to hand the policies of insurance thereon to the said X Bank.

[Signed] R ."

the bank as agreed in the trust receipt, the importer hands the warehouse receipts and insurance to the bank, and the trust receipt is canceled. The entry and warehousing have been accomplished in the same manner and with the same effect as if the bank had sent its own messengers or brokers to accomplish them. It has simply saved this expense, which would be chargeable to the importer, and avoided this trouble, by availing itself of the assistance of the importer, who, as will readily be observed, is interested in seeing that they are properly attended to and who can save some expense, by himself performing these incidental functions.

It may happen that the importer R has already found a purchaser for the silk at the time of its arrival, who is to pay either cash or on some agreed terms of credit, such as notes or acceptances. In that case there will be no occasion for warehousing the goods and consequently this first form of trust receipt may never be used.

In any case, the next step is likely to be as follows: R advises the bank that P is prepared to buy the silk and requests the bank to permit him to make the sale. The bank accordingly hands him either the bill of lading or the warehouse receipt, as the case may be, receiving in return a trust receipt in slightly different form.[2]

[2] "Property in Trust. Received from the X Bank the merchandise specified in the bill of lading per S. S. Juno, the property of the said X Bank, viz., 100 Bales Raw Silk marked A. B., imported

R thereupon delivers the silk to P, the purchaser, who in most cases is not informed as to the interest of the bank in the transaction. R collects the proceeds and turns them over to the bank as provided in the trust receipt. The bank pays itself in full with charges and interest, and credits to R's account any balance remaining. The trust receipt thereupon is cancelled or returned; at any rate, it is exhausted and the transaction is closed. R, by the use of this machinery has, without the use of a dollar of his own money, made an importation of silk from China, sold it to a domestic consumer, and received his

under the terms of their letter of credit No. 200 issued for our account, the said bill of lading to be used by us for the sole purpose of obtaining possession of above merchandise, and delivering the same to P who have purchased the same for cash/notes payable in and to obtain from the purchasers the proceeds of the sale of the same.

"In consideration of the delivery of said merchandise to us in trust as above, we agree to deliver it immediately to the said purchasers, and to collect the proceeds of sale, and immediately deliver such proceeds to the X Bank, in whatever form collected, to be applied by them against the acceptances of the X Bank, on our account, under the terms of letter of credit No. 200 issued for our account and to the payment of any other indebtedness of ours to the X Bank. It is understood, however, that if such proceeds be in notes or bills receivable, they shall not be so applied until paid, but with liberty meanwhile to the X Bank to sell or dscount and so apply net proceeds.

"The X Bank may at any time cancel this trust, and they may take possession of said goods until the same have been delivered to said purchasers and the proceeds of sale received from them, and thereafter of such proceeds wherever the said goods and proceeds may then be found, and may collect the proceeds, and in the event of any suspension or failure or assignment for the benefit of creditors on our part, or of the non-payment at maturity of any obligation or acceptance made by them under said credit, or any other credit issued by the X Bank, on our account, or of any indebtedness on our part to them, all such obligations and acceptances and all indebtedness shall thereupon (with or without notice) become due and payable.

[Dated]

[Signed] R ."

profit from the transaction, but at no time has he held the title to any part of the silk. Nevertheless, he has occupied the position of a principal; he has never been a mere broker, factor or agent. He has assumed the primary risk, and his credit with the bank and his business initiative have made the transaction possible. No one has a claim to any share of his profits. The bank, on the other hand, has obviously intended to do the business on a secured basis; it has intended to obtain the title and legal control over the goods at the outset and to retain them until they finally pass to P, the ultimate purchaser, but it has no further interest in the silk beyond the repayment of its advances and charges. The title is, therefore, solely a security title, though during part of the time divorced from physical possession which is entrusted to the person principally interested, namely, the importer. We shall proceed to examine the nature, validity, extent and limitations of this security arrangement.

Before doing so, another form of the transaction should be noted. The importer may be a manufacturer of silk, and may desire to obtain possession of the imported raw material for the purpose of changing its form and increasing its value by the application of labor, before offering it for sale. He may intend to accomplish these purposes by combining it in various proportions by the application of labor with other constituent materials, thus producing the

manufactured goods for sale. Or he may desire merely to sell as opportunity offers. In any such case, he may obtain the silk from the bank by signing a trust receipt which varies from the foregoing in that, instead of authorizing a sale to a named buyer, it states that the property is delivered to the importer to hold as the property of the bank,

> " . . . with liberty only to manufacture or to sell the same, manufactured or unmanufactured, accounting for the proceeds to the said Bank, but without liberty to pledge, until all bills of exchange drawn for our account on the said Bank shall have been paid or satisfactorily provided for."

It also contains provisions regarding insurance, etc. In such a case, the manufacturer is expected to turn over the proceeds of sale to the bank as and when received. As soon as the advances made by the bank are paid in full with charges and interest, it regards the trust receipt as satisfied and makes no further claim upon the silk or its products, regardless of whether or not the proceeds of the entire shipment have been delivered to it. This fact again indicates the strictly security nature of the arrangement.

It is also not uncommon for the banker to deliver documents or goods against trust receipt for the purpose of enabling the signer to make shipment to a distant buyer and to obtain bill of lading therefor which he is thereupon to hand to the bank.

In the foregoing sketch, we have assumed an im-

portation of goods from abroad. It is obvious that the trust receipt might equally well be used in connection with a domestic transaction, such, for example, as a shipment of automobiles from a manufacturer in Detroit to a customer in Philadelphia. The railway bill of lading may be taken or endorsed to the order of a bank in Philadelphia, which has agreed to honor drafts for the purchase price and, upon arrival, the automobiles may be turned over for sale on the security of a trust receipt given to the bank by the customer. Such use of the trust receipt is by no means infrequent, but its most extensive use is in connection with importations from abroad.

II

The various forms of collateral security may generally be classified under the headings: pledge, conditional sale, or mortgage. The trust receipt does not on its face or by its name purport to conform to any of these types. Obviously, a bailment of goods takes place—a delivery of possession with an intention to retain the title or at least certain rights akin to title. The use of the word "receipt" suggests a recognition of this fact. The word "trust," however, raises further question. An equitable trust requires a trustee; the document recites that the goods are received "in trust," thus indicating the notion that the signer is a "trustee" for the benefit of the bank. This involves the holding of the so-called legal title by the trustee for the benefit of a *cestui que trust* who has no legal title but rather certain beneficial interests cognizable in equity. This relation is entirely contrary to the expressed intention of the instrument which clearly stipulates that title of "the property" shall at all times, as between the parties, remain in the bank. We must conclude, therefore, that the word "trust" contains a fiduciary relation or perhaps merely a contractual obligation respecting the property. The equitable law of trusts will not provide the answer as to the nature of the arrangement or the rights of the parties.

The arrangement does not constitute a pledge. The security of a pledge depends entirely upon possession in the party secured. When possession is lost, the security is lost. The title in the case of a pledge is assumed to be in the pledgor or at least in another than the pledgee. This is exactly contrary to the trust receipt situation, where the title is intended to remain in the party secured while possession is entrusted to another who has a certain interest as yet undefined in the property.

Another form of security which has come to be recognized either by statute or practice is the conditional sale. A seller of phonographs, for example, delivers a machine to a buyer under a contract whereby payments are to be made from time to time on account, but with the stipulation that

title shall remain in the seller until full payment has been completed, with the proviso that on default in any payment, possession may be reclaimed by the seller. This arrangement bears a closer resemblance to the trust receipt than does a pledge. The courts of Connecticut have even gone to the extent of defining the trust receipt situation as a conditional sale.[3] There are, however, real points of differentiation. In a conditional sale, possession cannot be retaken until a default, whereas in a trust receipt it can be retaken at any time. In the second place, the bank is not interested in selling goods as a business, nor is it immediately interested in the commercial value or market for the property. If it retakes the goods and sells them for an amount in excess of this sum, this excess belongs to the importer. But in a conditional sale, the buyer is interested only in such amount as he has paid on account of his contract.

But more important than any of these points of difference is the fact which stands out clearly from the terms of the credit agreement and the trust receipt, that the importer has no intention of buying goods from the bank and that the bank has no intention of selling goods to him. The bank has loaned him credit and then advanced money for his account. If he does not repay this, the

[3] *New Haven Wire Co. Cases* (1888) 57 Conn. 352, 18 Atl. 266.

bank will sue him—not for damages for breach of contract in failing to buy and pay for goods—but rather for money loaned. This makes it clear that the substance of the transaction is a loan of money against security rather than a contract for the purchase and sale of goods as between the bank and its customer. In so far as goods are involved, they bear a subordinate and collateral relation. The obligation of the importer to repay the loan is not contingent upon the arrival of the goods or upon their delivery to him. They have been imported at his risk and had they been lost or destroyed en route, he would still and to the same extent have been obliged to repay the advance.[4]

It remains to consider the trust receipt in respect to its relation to the law of mortgages. A mortgage, whether of chattels or realty, historically is a security dependent on title as distinguished from a pledge which rests upon possession. Title is given to the person secured, while possession may be given to the mortgagor or debtor or his representative.

It is almost universally provided in this country that a chattel mortgage is valid as against creditors or bona fide purchasers for value, only if it is recorded. Inasmuch as it is not the common practice to record trust receipts, it becomes decidedly im-

[4] See *In re McElheny* (1904) 91 App. Div. 131, 86 N. Y. Supp. 326.

portant to consider the trust receipt in the light of the law of mortgages. If it be argued that the banker has a "lien" on some theory akin to the lien theory of mortgage as applied in various jurisdictions to real estate, it is difficult to see how the theory can be reconciled with the facts.[5] The importer never had title to the goods up to the time when the bank made its loan of credit or advance of money. The goods were the property of strangers perhaps in China. They were not the agents of the importer but were sellers of goods. They clearly transferred their title to the bank by taking and delivering a bill of lading to its order.[6] It is quite impossible to say that when they did this act they transferred title to the importers. So to hold would be to overturn much of the law regarding negotiable and semi-negotiable documents of title and would also be to violate the plain intention of the parties. The title was at that moment voluntarily transferred to the bank by the clear and effective acts of the parties. At that moment, the rights of the bank became fixed. It acquired, not a lien, but legal title.[7] The importer was never in a position to grant either a lien or title for he has never either owned or controlled the property. The

[5] The so-called lien theory of mortgages does not apply to chattels. *Noyes* v. *Wyckoff* (N. Y. 1883) 30 Hun 466, *aff'd*, (1889) 114 N. Y. 204, 21 N. E. 158; *Weeks* v. *Baker* (1890) 152 Mass. 20, 24 N. E. 905.

[6] See *Southern Flour & Grain Co.* v. *Central Texas Exch. Nat. Bk.* (Ga. 1921) 109 S. E. 685.

[7] See *In re Liberty Silk Co.* (D. C. 1907) 152 Fed. 844.

seller has retained no interest in the property, but has conveyed his entire title to some one else. It would be quite contrary to the fact and to the express stipulations of the parties to say that the seller, by delivering to the bank a bill of lading drawn to the bank's order, had thereby conveyed title to the importer, but had at the same time given a lien to the bank. The bank, therefore, prior to the delivery of the goods to the importer against his trust receipt, is clearly the title holder—not a lien holder.

When the bank delivers possession to the importer upon receiving the trust receipt, it is expressly stipulated that, as between itself and the importer, title shall remain in the bank. By what casuistry can it be argued that this stipulation means exactly the opposite of what it says? Can it be said that this act gives title to the importer and at the same moment retains a mere lien for the bank? This is neither what the parties stipulate nor what they intend, and, as between the parties, there is certainly no principle of law which makes it impossible for them to accomplish their express purpose, or which necessarily implies the accomplishment of an opposite result. When the rights of third parties are involved, it may very well be that this delivery may have results not entirely consonant with the intention of the parties, but we are not now considering that situation. Such rights can hardly

affect the true nature of the transaction as between the parties.

It remains to determine possible identity of the trust receipt with a chattel mortgage apart from any hypothesis of "lien." The essence of a mortgage may be said to be a conveyance of title to the mortgagee as security, coupled with certain rights in the property—equitable in their origin—in the mortgagor.

How closely do the facts of this arrangement coincide with those existing under a trust receipt? Title is found in the mortgagor prior to the mortgage. He conveys this title to the mortgagee as security for the performance of his obligation or for the obligation of another. In the case of a trust receipt title has never been in the importer and he consequently cannot convey it to the bank. It may happen, however, that a mortgagor conveys his title to the mortgagee as security for the performance of an obligation by a third person.[8] In that case, the equity of redemption belongs to him and not to the third person and the property reverts to him upon the performance of the obligation by the third person. But in a trust receipt, under no circumstances is the title to revert to the foreign seller. This fact, however, does not prove that there is not a mortgage. The mortgagor who has conveyed his title as security for the obligation of

[8] See *Blake* v. *Corbett* (1890) 120 N. Y. 327, 24 N. E. 477.

another, may readily convey his "equity" to the third person who owes the debt. That person then stands in the shoes of the mortgagor, for he has all the rights of the mortgagor, although he has never held the legal title.

Is that not exactly the situation which exists in the case of a trust receipt? An arrangement is made by the importer with the seller abroad looking to the purchase of goods. This clearly contemplates the acquisition of at least the beneficial interest in the property by the importer, subject to such arrangements for financing as he may make. He directs the seller to convey the legal title for the purpose of security to the bank and, by necessary implication, to convey, at the same moment, to him —the importer—the "equity," "equitable title," "equity of redemption," "residue of ownership," or by whatever name the rights of a mortgagor may be known.[9] From that time forth, the beneficial interest in the property is his, subject to the legal title in the bank as security for the performance of his obligations to it. Upon the performance of those obligations, the legal title reverts or passes to him as the person who has acquired and owns what we may for convenience continue to refer to as the "equitable title." This we submit is the correct

[9] See *In re Richheimer* (C. C. A. 1915) 221 Fed. 16, 22, 23, "residue of ownership."

explanation and definition of the relationship which exists between the importer and the bank. It is generically a chattel mortgage. Why, then, is it not so classified by the cases?

Our answer is that there are exceedingly strong reasons why the business should be done and the arrangement upheld without the necessity of recording the trust receipt. To record the numerous trust receipts which are taken by a bank having a letter of credit business of any magnitude, would be an almost intolerable burden and expense. And in practice neither banks nor merchants can take the time and trouble to search the records of the county clerk in handling the business of the day. To record a discharge of the trust receipt whenever it has served its purpose would again be an intolerable nuisance. Furthermore, it is too much to expect buyers to search the county clerk's files every time they do business with an importer. In short, business necessity renders recording entirely impracticable while at the same time it renders the use of the trust receipt highly convenient. Another reason why it should not be classed with ordinary chattel mortgages is the simple fact that it is not an ordinary chattel mortgage. The method of effecting sales and carrying on business involving transfers of title by means of draft with negotiable bill of lading attached, to be delivered upon payment of the draft,

is quite as old as the recording acts relating to chattel mortgages, and it is a practice equally old, for bankers to make advances for the payment of these drafts upon the security of the goods or the documents.

We have said that this creates a security which is generically a chattel mortgage. It is perfectly clear, however, that the situation is not one that would be recognized as a chattel mortgage by the man in the street. A chattel mortgage as generally understood means a conveyance of property by a borrower as security for his own obligation and the policy of the recording acts is directed at the apparent ownership based upon previous and continued possession by such borrower of property which formerly belonged to him. A secret transfer of title by such a borrower ought not to be effective to the injury of creditors who have relied upon his retention of possession. This vice does not exist in the trust receipt situation, for the borrower has not hitherto had possession. In construing the term "chattel mortgage," as used in recording acts, it is fair and proper to consider the normal, natural and common understanding of the meaning of the words, and, thus construed, the trust receipt situation is not a chattel mortgage, in spite of the fact that strict legal analysis shows that it possesses the attributes of that type of security. This is particularly true in view of the fact that the construction referred to

is called for by the needs of business convenience and commercial usage.[10]

The trust receipt is, as we say, distinguishable from the ordinary chattel mortgage. The distinction is one that exists in fact—it is real and it is clear-cut and workable. This ground of differentiation is the fact that title does not pass to the bank from the importer but rather from a third person. The importer has never held the legal title. He has arranged a purchase money mortgage to the banker, who makes the loan, without himself appearing in the chain of title.[11] No one is deceived by the fact that the bank has acquired a security title which is unrecorded, because there is no "retention of possession" by the importer. He has never had either possession or title.

To state it again the difference between the true trust receipt situation and the ordinary chattel mort-

[10] See Williston (1921) 34 Harvard Law Rev. 741, 758, 759; *In re Cattus* (C. C. A. 1910) 183 Fed. 733; *In re Richheimer, supra,* footnote 9.

[11] *In re Shulman* (D. C. 1913) 206 Fed. 129, was a case where the owner attempted to give security for his own debt, agreeing to hold the property "in trust" for the lender. The court said: "To make such a sale or pledge effective delivery or its equivalent is essential. . . . *The Trust Receipt cases . . . differ in this vital fact: In those cases the debtor had never acquired title to the property in question; the title had always been in some one else;* and his creditors were not allowed to deal with the property of this other person as if it were the debtor's, although the property had come into the debtor's actual custody." *In re Dunlap Carpet Co.* (D. C. 1913) 206 Fed. 726, 730-31: "Much of this trade could hardly be carried on by any other means, and therefore it is of first importance that the fundamental factor in the transaction, the banker's advance of money and credit, should receive the amplest protection. . . . This security is not an ordinary pledge by the importer to the banker, *for the importer has never owned the goods,* and moreover he is not able to deliver the possession" (author's italics).

gage is the fact that, in the trust receipt, title passes to the bank (the mortgagee) from the seller of goods, as security for the debt of a third party, while in the ordinary chattel mortgage, title passes to the bank (the mortgagee) directly from the party owing the debt. Let us look for a moment at an illustration. If a merchant having goods on hand belonging to himself transfers the title to a bank as security for a loan, the bank acquires a security title as between the parties and so long as it has possession of the goods or the documents of title it is safe, but if it were to redeliver the goods to the merchant or turn over to him the documents of title upon his signing a document worded in all respects like a trust receipt, without recording the same, there can hardly be any question that the transaction would be held to be a chattel mortgage (assuming it is not a pledge) and that such a trust receipt would be valueless by way of special security. But, if the merchant being about to buy goods, directs the seller to convey the title direct to the bank which advances the purchase price, and if the bank then delivers the goods to the merchant against a trust receipt, the legal situation between the parties will be essentially the same as in the last case, but the legal results will not by any means be the same.

The failure to recognize the distinction to which we have called attention has led occasionally to

the use of the trust receipt in circumstances where it cannot assure any special rights beyond those secured by an ordinary contract or unrecorded chattel mortgage.[12] To take an example: A borrower pledges warehouse receipts, negotiable stocks or bonds, or goods with a bank as security for a loan. Not infrequently he asks, shortly thereafter, that the property be returned to him against his trust receipt and sometimes his request is granted, presumably on the supposition that the bank is retaining some special security rights in the property by reason of holding the trust receipt. In this, it is entirely mistaken. It has from that moment no security whatever which it would not have as holder of an unrecorded chattel mortgage or a mere contract. It may not, in fact, have even that, if the deposit was by way of pledge rather than mortgage. It should be remembered that security is generally needed only in time of trouble. However honest the intentions of the borrower, if bankruptcy intervenes, the property will be held as part of his estate by the receiver or trustee; the bank will not be able to recover it or its proceeds, but will be

[12] See *In re Gerstman* (C. C. A. 1907) 157 Fed. 549; *In re Shulman, supra,* footnote 11; *In re Dernberg & Son* (1921) 66 N. Y. L. J. 1200.* This decision was affirmed and a contrary holding upon similar facts *In re Fountain* (not reported below) was reversed by the C. C. A., 2nd Circuit 282 Fed. 816. See also *In re Cullen* 282 Fed. 902 (D. C. Md.) *American & British Sec. Co.* v. *American & British Mfg. Co.* (D. C. 1921) 275 Fed. 121; *Salinas City Bk.* v. *Graves* (1889) 79 Cal. 192, 21 Pac. 732; *Bell* v. *New York Safety, etc. Co.* (C. C. 1910) 183 Fed. 274; *Fletcher American Nat. Bk.* v. *McDermid* (Ind. 1920) 128 N. E. 685; *Lewis* v. *Bank of Mobile* (Ala. 1920) 87 So. 176.

obliged to claim as a general creditor.[13] It would seem from experience that these facts are not appreciated by the users of trust receipts. A trust receipt can afford superior protection as compared with an unrecorded chattel mortgage only when it is used in the circumstances which we have described, namely, when the title to the property (as distinguished from mere possession which connotes a pledge) is given to the bank by some one other than the debtor and where the later delivery of possession against trust receipt is made to the debtor. In commercial practice, this situation seems to exist only in connection with the financing of importations or domestic purchases.

III

At this point it is perhaps desirable to refer more particularly to the recording laws and the policy upon which they are founded. Recording laws were, until recently at least, peculiar to the United States. A mortgage of property is undoubtedly valid, as between the parties, without recording. But, to protect the mortgagee against a bona fide subsequent grantee or mortgagee or against the

[13] *In re Gerstman, supra,* footnote 12; *In re Shulman, supra,* footnote 11; *In re Dernberg & Son, supra,* footnote 12. A pledge or mortgage of choses in action is not within the recording act. See New York Lien Law § 230, N. Y. Cons. Laws (2d ed. 1920) 1093, am. 1921; *Sexton* v. *Kessler & Co., Ltd.* (C. C. A. 1909) 172 Fed. 535, *aff'd* (1912) 225 U. S. 90, 32 Sup. Ct. 657; *Stockyards Nat. Bk.* v. *First Nat. Bk.* (C. C. A. 1918) 249 Fed. 421.

claims of creditors, it is necessary, unless the mortgagee retains possession of the property, to record the instrument. Such recording is generally regarded as notice to all concerned. In the case of personal property, the reason for the rule is somewhat different than in the case of realty. Possession of real property is only to a slight extent an evidence of ownership, but in the case of personalty it has long been asserted that possession is one of the strong evidences of title, and the policy has, to a great extent, been adopted, that we will not "suffer without notice to the world the real ownership to be in one person and the ostensible ownership in another" for the reason that it gives a false credit to the latter which leads to injury to third persons.[14] Consequently, laws are in general force providing for the recording of chattel mortgages and conditional sales. There can be no question as to the power of the legislature to include trust receipts under this principle. It has been held, however, in many states that the trust receipt is not a "mortgage" or "conditional sale" within the meaning of the existing recording laws. Such a ruling finds its justification in business necessity and in a real difference in the situations as has already been pointed out. It is, however, entirely possible to frame a recording act in such a way as to include

[14] See *Century Throwing Co.* v. *Muller* (C. C. A. 1912) 197 Fed. 252, 258.

trust receipts. The wisdom of so doing is open to serious question. Some of our states have, however, taken this step.

In *In re Bettman-Johnson Co.*,[15] the question arose with respect to the Ohio recording statute. Cherries had been imported in the usual way and delivered to the importer against his trust receipt. They were in his possession at the time of his bankruptcy and the bank endeavored to recover possession of them. The court admitted that the bank held the title for the purpose of security, but held that as against general creditors or a receiver or trustee, the property could be claimed by the bank only if the trust receipt had been verified and filed in the recorder's office in accordance with the recording act. The trust receipt is, therefore, practically valueless in Ohio when not recorded. In Illinois, also, it appears to be conclusively settled that a trust receipt is valueless as against creditors or a trustee in bankruptcy unless duly acknowledged and recorded.[16]

[15] (C. C. A. 1918) 250 Fed. 657.

[16] In the case of *In re Richheimer, supra*, footnote 9, the importer repledged a large part of the goods imported and delivered to him under trust receipt. As to such portion, the rights of the pledgee were held to be superior to those of the holders of the trust receipts. That result occasions no comment at this point, although there is no factors' act in Illinois. The court further held, however, that the holders of the trust receipts could not recover the possession of a portion of the shipment which had not been so pledged, but which had remained in the possession of the importer and thence passed into the hands of the trustee in bankruptcy. This holding was explicitly made upon the strength of the recording act, upon the ground that the trust receipt fell within the policy of that act as to secret liens and reservations of title. The trust receipt in Illinois, therefore, if unrecorded, is without special value

In Virginia the standing of a trust receipt appears uncertain. In *Boice* v. *Finance & Guaranty Corporation,*[17] a dealer in automobiles financed the purchase of several cars with the aid of the Finance Corporation and gave to it chattel mortgages *which were duly recorded* and which did not contain any express power of sale. He then sold one of the cars to Boice and failed to pay off the mortgage with the proceeds. The Finance Corporation brought an action of detinue against Boice. The court held that under the statutes and policy of Virginia, the car belonged to Boice in spite of the constructive notice of the record, since he had no actual notice. The theory was that the property was put in the hands of a dealer ostensibly for sale and that this in effect constituted a power of sale. The court said:

"Property bought for the express purpose of daily indiscriminate sale to the general public, exposed for such sale at the place of business of a licensed dealer, and over which the dealer is permitted to exercise the dominion of owner, cannot be made the subject of a valid chattel mortgage . . .

as security. See *Union Trust Co.* v. *Trumbull* (1891) 137 Ill. 146, 27 N. E. 24. In *In re Harnden* (D. C. 1912) 200 Fed. 175, it was held that in New Mexico a chattel mortgage of goods is not void as a matter of law because the mortgagor retains possession and can sell in the usual course of business without accounting to the mortgagee. The federal courts, of course, follow the local state law on this question. It is interesting to contrast the reasoning and result of the *Richheimer* case with that of *In re E. Reboulin Fils* (D. C. 1908) 165 Fed. 245, decided with reference to the law of New Jersey, which permitted the recovery of goods or their proceeds from a trustee in bankruptcy.

[17] (1920) 127 Va. 563, 102 S. E. 591.

the powers which the dealer is permitted to exercise over the property in such case are inconsistent with a mortgage thereon."[18]

This does not, of course, directly bear upon the trust receipt, since a power of sale is usually given in that instrument. There is, however, language in the opinion which affords basis for the view that such a mortgage, even though recorded, is invalid in Virginia as against creditors of the mortgagor. It seems doubtful whether the court in a square case would go to the full extent of that expression. The principle seems to be of doubtful validity in any case except that of a purchaser in ordinary course of business from a dealer.[19] General creditors who were such at the time of the making of the mortgage have not been deceived or injured. Later pledgees or mortgagees of the property should certainly be charged with notice of the earlier mortgage which has been recorded, since they are not in a similar position to that occupied by ordinary buyers. The same may be said of later general creditors. The opinion in this case, however, raises doubt as to the validity of trust receipts in Virginia.[20]

[18] See also *O'Neil* v. *Cheatwood* (1920) 127 Va. 96, 102 S. E. 596.

[19] See *Bryant* v. *Swofford Bros.* (1909) 214 U. S. 279, 29 Sup. Ct. 614; *In re Pierce* (C. C. A. 1907) 157 Fed. 757.

[20] See also *Glass* v. *Continental Guaranty Co.* (Fla. 1921) 89 So. 876. In that case the dealer had no express power of sale. The agreement was not recorded. The holder of the trust receipt failed in an effort to recover possession from a bona fide purchaser.

A recent decision[21] of the United States District Court for the Eastern District of South Carolina raises most serious questions as to the law of South Carolina. Here a domestic purchase was financed and the goods turned over under a trust receipt which was not recorded. The court held that the instrument was in the nature of a chattel mortgage and that under the South Carolina statute such an instrument was void as against subsequent creditors without notice unless recorded. Possession of the goods had been retaken by the holder of the trust receipt prior to the bankruptcy, but the court directed that it be returned to the trustee in bankruptcy for administration as part of the general assets of the estate.

This decision seems to be open to serious question. By "subsequent creditors" can hardly be meant general creditors, but rather subsequent pledgees, mortgagees or others who have obtained specific rights in the property by attachment, levy or otherwise.[22] There were none such at the time when the possession was retaken by the defendant prior to the bankruptcy. How could the fact that temporary possession had been given to the signer of a trust receipt under a contract presumably good between the parties, affect the rights of the defendant as a security holder *in possession* after such possession had been retaken? Obviously, it could affect the rights only if the contract was void as between the parties. Only on this basis could the delivery be held to constitute a preference. If the contract was good as between parties, then redelivery was not preferential.[23] The decision, unless based upon the express statutes of South Carolina, is opposed to the overwhelming weight of authority.

The law in Louisiana, on the other hand, goes to the opposite extreme. In *In re Dreuil & Co.*,[24] the situation was not what we have termed a proper one for the use of a trust receipt. The bankrupt pledged bills of lading to a bank. It regained possession by signing a trust receipt. It then warehoused the goods and pledged the warehouse receipts and again obtained possession by signing a trust receipt. In Louisiana, a pledgee apparently obtains title and the case therefore presents what would ordinarily be called a chattel mortgage. The banks (pledgees) combined and asked for the possession of the goods from the trustee in bankruptcy. In other jurisdictions they would have failed.[25] In Louisiana they were successful.[26] This can only mean that the return of pledged property to the pledgor is not neces-

[21] *Cappleman* v. *Industrial Finance Corporation* (1921),* aff'd C. C. A. 284 Fed. 8.
[22] See *Union Trust Co.* v. *Trumbull, supra,* footnote 16; *Skilton* v. *Codington* (1906) 185 N. Y. 80, 77 N. E. 790.

[23] *In re Perlhefter* (D. C. 1910) 177 Fed. 299.
[24] (D. C. 1913) 205 Fed. 573.
[25] *In re Gerstman, supra,* footnote 12; *In re Shulman, supra,* footnote 11; *In re Dernberg & Son, Inc., supra,* footnote 12.
[26] See also *Commercial Nat. Bk.* v. *Canal Bk.* (1916) 239 U. S. 520, 36 Sup. Ct. 210; *In re Dreuil, supra,* footnote 24; s. c. (C. C. A. 1914) 211 Fed. 337.

sarily fatal in that state. Prior to 1918, chattel mortgages were in general apparently unknown in Louisiana law.[27] They now depend upon a statute[28] the form of which is quite different from that in common use elsewhere. A Louisiana pledge has hitherto been similar in effect to what is known elsewhere as a mortgage, and possession could only be returned to the pledgor for a special or temporary purpose.[29] The *Dreuil* case can only be explained satisfactorily by reference to the special legal system of Louisiana.

IV

We will now examine in some detail the history of the peculiar doctrine of trust receipts. They represent a comparatively recent development in the law relating to commercial banking and security.

In 1843, Judge Story rendered a decision[30] in the federal Circuit Court of Massachusetts, under the following circumstances: The plaintiffs had loaned money to the bankrupt for the purchase of goods under his agreement to pledge the property bought as security for the loan and, meantime, to hold the bills of lading and other documents for the plaintiffs' account. He disposed of part of the goods.

[27] See *Delop* v. *Windsor* (1874) 26 La. Ann. 185.
[28] Laws 1918, No. 198.
[29] *Britton* v. *Harvey* (1895) 47 La. Ann. 259, 16 So. 747; *Jacquet* v. *Creditors* (1886) 38 La. Ann. 863.
[30] *Fletcher* v. *Morey* (C. C. 1843) 2 Story 555.

He later became bankrupt, his assignee (*i. e.*, trustee) held part of the goods and the proceeds of other parts sold. The plaintiffs brought an action in equity to establish a lien on the property and proceeds in the assignee's bonds. Judge Story upheld the bill and gave the property to the plaintiffs. He spoke of the case as an "equitable lien" without determining whether it was an equitable pledge or mortgage, and held in principle that it was enforcible against all except bona fide purchasers from the bankrupt for valuable consideration and without notice.

Equitable mortgages of realty had long been enforced, but this appears to be one of the earliest cases in which an analogous equitable right was recognized and enforced in respect to personalty.[31]

This case is really similar to a trust receipt case. It would have been precisely such a case if the bills of lading had been drawn to the order of the lender and by him delivered against a trust receipt. The agreement seems to have contemplated that the title should pass directly to the lender as security even though it was spoken of as a "pledge." If so, the decision is in accord with modern law on the subject. In later cases, we find that the rights of the

[31] Equitable assignment: *Lowery* v. *Steward* (1862) 25 N. Y. 239; see also *German Bk.* v. *Edwards* (1873) 53 N. Y. 541; *Parshall* v. *Eggert* (1873) 54 N. Y. 18. Equitable mortgage to secure the debt of a third person: *Blake* v. *Corbett*, *supra*, footnote 8. Equitable mortgage: *National Bk. of Deposit* v. *Rogers* (1901) 166 N. Y. 380, 59 N. E. 922; *Sexton* v. *Kessler & Co., Ltd.*, *supra*, footnote 13.

lender are upheld, even though no trust receipt has been used, provided the agreement between the parties is clearly shown and no superior equities have intervened.[32] The case is illustrative of the readiness of the courts to recognize the needs and practices of business and to protect creditors in connection therewith so long as superior equities do not intervene. In later trust receipt cases, the fundamental principle of this decision seems often to have been in the minds of the court. Again possession is said in general to be essential to the rights of a pledgee, but the courts have repeatedly recognized the principle that a pledgee might relinquish possession to the pledgor "for a special purpose," giving him what might be termed custody or a limited control without losing his rights as pledgee.[33]

Another early case which resembles the trust receipt situation was decided in New York in 1874.[34] The plaintiff discounted a draft drawn on the consignee and received the bill of lading with the draft. The consignee refused to pay the draft but obtained the goods by an attachment and sold them.[35] It was held that *the plaintiff was a mortgagee in possession*

[32] *In re Marks & Co.* (C. C. A. 1915) 222 Fed. 52; *Merchants' Exch. Bk.* v. *McGraw* (C. C. A. 1896) 76 Fed. 930; *Southern Flour & Grain Co.* v. *Central Texas Exch. Nat. Bk.* (Ga. 1921) 109 S. E. 685. It must be noted, however, that in none of these cases have the goods previously belonged to or been in the possession of the borrower and prospective buyer.

[33] *Hutton* v. *Arnett* (1869) 51 Ill. 198; *Thayer* v. *Dwight* (1870) 104 Mass. 254.

[34] *First Nat. Bk.* v. *Kelly* (1874) 57 N. Y. 34.

[35] See also *Merchants' Exch. Bk.* v. *McGraw, supra,* footnote 32.

through its possession of the bill of lading, that it was not required for that reason to record the mortgage, and that it was entitled to be paid the amount of the draft out of the proceeds of the property. This case is interesting because it recognizes the situation as a chattel mortgage. The plaintiff was in exactly the same situation as the banker who hands the importation to his customer against a trust receipt. In this case, the buyer obtained the property without signing a trust receipt, but also without the bank's consent. The court, therefore, was able to give protection to the bank while at the same time it recognized that the bank was the holder of an unrecorded chattel mortgage. When the next step was presented by facts similar to those found in a trust receipt case[36] in which the debtor obtained possession with the bank's consent, the court still gave protection to the bank (although it was as the court had already held in the last case, the holder of a special variety of unrecorded chattel mortgage) by declining to admit that the arrangement was in all respects a mortgage. The ultimate result was, in effect, the recognition that it was not such a chattel mortgage as to come within the terms of the recording acts.

The line of cleavage thus becomes clear. In the later cases, in New York at least, there is a distinct

[36] *Mechanics & Traders' Bk., etc.* v. *Farmers & Mechanics' Nat. Bk.* (1875) 60 N. Y. 40.

unwillingness to define the rights of the bank by name, but it is universally recognized that it has a security title. In *Mechanics & Traders' Bk., etc.* v. *Farmers & Mechanics' Nat. Bk., etc.*,[37] the court said:

"The judge ruled at the trial that the plaintiff [the lending bank] was a mortgagee of the grain; but whether the plaintiff held it as mortgagee, pledgee, or by any other title is not material, so long as the title or the right to the possession was vested in the plaintiff. To all intents and purposes the plaintiff's property in the wheat was clearly established and beyond any question."

As the action was for conversion of the wheat, the case can hardly be explained as one of equitable mortgage or pledge. If it was a pledge, the bank had surrendered possession, whether for a special purpose or not. But the court said further: "The [warehouse] receipt taken for the wheat by W [the intended buyer], in his own name, was without authority and did not divest the plaintiff of the title which had been lawfully acquired." [38]

The general doctrine was upheld by the Supreme Court of the United States in 1875 in *Dows* v. *National Exchange Bank of Milwaukee*,[39] an important case coming from the State of New York.

[37] *Ibid.* 47.
[38] *Ibid.* 51. For the later litigation growing from the facts of this case, see *Farmers & Mechanics' Nat. Bk.* v. *Erie Ry.* (1878) 72 N. Y. 188.
[39] (1875) 91 U. S. 618.

A bank discounted a draft accompanied by a bill of lading drawn to its order. It forwarded the papers to its correspondent with instructions to deliver only on payment of the draft. The goods were placed in a warehouse of the drawee who acknowledged receipt as warehouseman only. He, however, sold the goods and delivered them to another. The court held that the bank's correspondent could not divest its title prior to payment of the drafts; that the goods were placed in the drawee's hands not as owner but as bailee, *i. e.*, for a special purpose; that the title of the bailor was not lost by such delivery and that a sale or delivery by the bailee gave no title to the purchaser, who was therefore liable for conversion.

The bearing of these early cases is obvious. They contain the essential principle of the trust receipt doctrine. It is interesting to note, however, that every one of them arose in connection with a domestic transaction, whereas the name of trust receipt is chiefly associated with importations from abroad.

The earliest reported case in which the word "trust receipt" is used appears to be *Barry* v. *Boninger*,[40] decided in 1877. The precise form of the instrument is not stated but in substance it appears to have resembled those now in use. It was used in connection with the delivery of an importa-

[40] 46 Md. 59.

tion of sugar to the importer, who had obtained a credit therefor from the bank. It gave a right of sale with the obligation to account for the proceeds until all drafts were paid. Sale was effected through brokers. The importer failed and the brokers attempted to withhold from the proceeds not only their commission for the particular sale, but other commissions due them from the importer. The court held that the property in the sugar was in the bankers under the letter of credit and the trust receipt, and that the brokers could not withhold from the proceeds the amount of commissions due them from others (*i. e.,* from the importers).

We may be permitted to pause at this point to consider further the origin of the name "trust receipt." The use of the word "receipt" is obviously appropriate, but, as has already been remarked, the equitable notions of a "trust" are quite different from those connected with the importer's obligations. Perhaps the word "bailment" would more accurately describe the situation.[41] Indeed, the term "bailee receipt" is not unknown in connection with documents intended to accomplish the same purpose as trust receipts. It is, however, uncommon and it would appear from various points of view to be undesirable to use a new or unaccustomed name for documents which have become generally

[41] See *Century Throwing Co.* v. *Muller, supra,* footnote 14.

familiar to the courts as well as to the business world as trust receipts.

Fiduciary obligations are not, however, within the exclusive province of equity. If A delivered property to B, whether goods or a sum of money, for a special purpose such as for the purpose of delivery to C or to sell and turn over the proceeds to A, this constituted a bailment and gave rise in early English law to the law action of account. This is now obsolete, but its successors are detinue and replevin, and the relation between the parties was that of a common law trust—an entrusting or bailment. In this sense, the use of the word "trust" is entirely apt, but its significance is in sharp contrast to that of the creature known to equity as a "trust." In a common law trust the title is in the entrusting party—the bailor. In an equitable trust, title is in the entrusted party—the trustee. It seems highly probable, therefore, that the name "trust receipt" is derived from the common law notion of trust and in that view the name, as a whole, is appropriate. It is doubtless also a fact that the word "trust" has a value in business where legal refinements mean little. Its use may unconsciously cause the importer to observe the obligation with greater care because of a high respect for, though unaccompanied by a refined understanding of, the obligations of a "trustee."

It was not long before other decisions in New York were handed down which firmly established the foundations upon which trust receipts are built. The most important is *Farmers & Mechanics' Nat. Bk.* v. *Logan.*[42] This case, like its predecessors in New York, arose in connection with a domestic shipment of grain. The bank took the bills of lading to its own order against draft drawn on the buyer, who had initiated the transaction. Upon the acceptance of the draft, he was handed the bills of lading without endorsement, accompanied by a writing saying that the grain was pledged with the bank and was put into his custody "in trust" as security for the payment of the draft. He was given no power of disposal. He, however, sold to the defendant Logan and another. The court held distinctly that the bank was not a mere pledgee, as it was agreed that retention of possession by the bank was essential to a pledge as against a bona fide purchaser from the pledgor. In resting its case upon the title of the bank, it laid preëminent stress upon the fact that such title had come to it from another source than the buyer. It recognized that he had some interest or right in the property but it did not define that right and it carefully avoided any mention of what it may have regarded as a disastrous term—"mortgage." The opinion reads as if the court thought the great principle involved was

[42] (1878) 74 N. Y. 568.

"caveat emptor." [43] In this case, the defendant had actual notice of the rights of the plaintiff. It is, of course, obvious that if a trust receipt is valid as between the parties, it loses none of its validity by a transfer of the property to one who has notice of the rights of the holder of the trust receipt.[44]

Following these decisions, instruments framed to give security under the principles established by them began to be used in business in New York. One such instrument resembling a trust receipt is found in *Carter* v. *Arguimbau,*[45] decided in 1884. In that case, imported goods had been delivered to an importer who signed a receipt giving him power to sell. The receipt contained the obligation to hold the goods and their proceeds "under lien" as agent of the bankers. The word "lien" is sometimes found in trust receipts in use at the present time. It invariably gives rise to difficulty, although the courts are careful to explain it.[46] There is no occasion for its use and it should be scrupulously avoided. The banker has title, not a lien. As was said in *In re Liberty Silk Co.*[47]

[43] See also *Farmers & Mechanics' Nat. Bk.* v. *Atkinson* (1878) 74 N. Y. 587; *Farmers & Mechanics' Nat. Bk.* v. *Hazeltine* (1879) 78 N. Y. 104.

[44] See *Cole* v. *Mann* (1875) 62 N. Y. 1.

[45] 31 Abb. N. C. 3.

[46] See *In re Cattus, supra,* footnote 10.

[47] (D. C. 1907) 152 Fed. 844. In this case there was no trust receipt, but a mere provision to "retain a prior lien upon the under noted goods until payment has been made." The contract also purported to give "a prior lien upon the goods . . . or an equivalent value until payment has been made." The customer was obviously intended to sell the goods or use them in the course of

"A seller cannot at the same time retain title to that which he sells and a lien on the article sold. A lien in favor of A, whether it be regarded as a *jus in re* or a *jus ad rem,* presupposes title in another and A's acquirement of title extinguishes his lien."

In the case of *Carter* v. *Arguimbau,* the importer's property was in the hands of an assignee for the benefit of creditors, and the banker sought to recover the possession of the goods remaining unsold and of the proceeds of those sold. The holding was that he was entitled to such goods and proceeds in so far as they could be traced.[48] The court expressly refused to construe strictly the words "under lien" saying that they should be regarded as meaning "subject to the prior claim of the bankers." This case does not involve the factors' act, but it was of necessity a direct decision that the receipt which was in the nature of a trust receipt was effective, even though not recorded.[49] The court did

manufacture, and the terms of the delivery imposed no obligation to account for the proceeds. Quite naturally the arrangement was overthrown in favor of the trustee in bankruptcy. There seems to have been no attempt to do the business on the basis of trust receipts or upon the theory of reservation of title upon which they depend, although it would seem that the transaction could have been carried through in such a manner as to gain the protection afforded by trust receipts.

[48] See also *Dennistown* v. *Barr* (1893) 31 Abb. N. C. 21; 28 N. Y. Supp. 255.

[49] It seems that an unrecorded chattel mortgage would be valid in New York under similar circumstances. *Skilton* v. *Codington, supra,* footnote 22. The earlier rule seems to have been more severe. *Stephens* v. *Perrine* (1894) 143 N. Y. 476, 39 N. E. 11. An assignee for the benefit of creditors, however, has no rights superior to those of his assignor. *Bell* v. *New York Safety, etc. Co., supra,* footnote 12; *Wilson* v. *Esten* (1885) 14 R. I. 621.

not attempt to define the nature of the security position of the bank.

In *Moors* v. *Kidder,*[50] an importation was delivered to the importer under an agreement analogous to a trust receipt, for the sole purpose of making customs entry and warehousing. The importer, however, pledged it to a lender who did not, however, take it in reliance upon the bill of lading, which was in the importer's hands. This is an important case in connection with the factors' act, and the pledgee was unsuccessful in maintaining the pledge because the importer had no power of sale, and because the lender had not placed reliance upon the importer's apparent title represented by the bill of lading which was not shown to him. The receipt spoke of the goods as being "pledged and hypothecated" with the bankers. The court refused to construe these words strictly, saying very pertinently that "very likely the transfer was rather in the nature of a mortgage in which the title passes than in that of a pledge in which the pledgor is the general owner."

The first reported case which has been found in New York in which the term "trust receipt" is used is *English Bank of Rio de Janeiro* v. *Barr.*[51] The decision was in accord with *Carter* v. *Arguimbau.*

[50] (1887) 106 N. Y. 32, 12 N. E. 818.
[51] (1888) 31 Abb. N. C. 7.

By this time the trust receipt was in common use under that name.

At about the same time, the Massachusetts courts established the law of that state in harmony with the New York decisions referred to.[52] They upheld the claim of the banker on the ground that he had a title which was not lost by delivery of the custody of the goods to the importer. At the same time, they were deciding that an unrecorded bill of sale or chattel mortgage, given to secure a loan made to the mortgagor, was not effective when not accompanied by possession of the property.[53] The only real distinction between the cases was that to which we have already called attention, namely, that in the first case the security title of the banker was derived from a person other than the debtor, whereas in the second the security title of the banker was derived from such debtor. This is the line of differentiation which must mark the proper trust receipt situation from that of the ordinary chattel mortgage.[54]

[52] *Moors* v. *Wyman* (1888) 146 Mass. 60, 15 N. E. 104; see also *Forbes* v. *B. & L. Ry.* (1882) 133 Mass. 154, as to the effect of delivery of a bill of lading.

[53] *Copeland* v. *Barnes* (1888) 147 Mass. 388, 18 N. E. 65; see also *Salinas City Bk.* v. *Graves, supra,* footnote 12.

[54] See also the opinions in the more recent case, *Peoples Nat. Bk.* v. *Mulholland* (1916) 224 Mass. 448, 113 N. E. 365, as contrasted with the same case in (1917) 228 Mass. 152, 117 N. E. 46, where, on further examination, the case was held to come within the trust receipt doctrine. Note also Professor Williston's criticism of the latter opinion in *Progress of the Law 1919-20* (1921) 34 Harvard Law Rev. 759.

In 1889, the courts of Connecticut passed upon the trust receipt and again upheld the banker.[55] They explicitly declared that the transaction was a conditional sale by the banker to the importer. The important thing was that they upheld the arrangement without recording. The use of the term "conditional sale" was probably due to the fact that in Connecticut a conditional sale agreement was valid without recording, whereas a chattel mortgage enjoyed no such immunity. The true nature of and justification for the doctrine was not as yet entirely clear.[56]

These cases were shortly followed by a decision in Wisconsin in which the right of the banker to the proceeds of goods sold by the importer who held them under a trust receipt was upheld as against the claims of creditors.[57] The creditors endeavored to persuade the court that the transaction was a conditional sale, which required recording in Wisconsin, but the court refused to affix a definite label, saying that if it was a conditional sale, it had in the particular case been made in either Connecticut or

[55] *New Haven Wire Co. Cases, supra,* footnote 3.

[56] See comment in *Charavay* v. *York Silk Mfg. Co.* (C. C. 1909) 170 Fed. 819, 822. In *Drexel* v. *Pease* (1892) 133 N. Y. 129, 136, 30 N. E. 732, the court said, in respect to a situation rather similar to that in a trust receipt, "the correspondent [the bank] occupies the position of an owner under a contract to sell and deliver when the purchase price is paid." In this case, the court refused to allow the bank to hold a balance remaining after the payment of the specific advances, as security for a prior debt, as against the claim of a third party who had a proprietary interest in the property unknown to the bank.

[57] *Mershon* v. *Moors* (1890) 76 Wis. 502, 45 N. W. 95.

Massachusetts, in both of which states it was valid without recording.[58]

In connection with these Massachusetts, Connecticut and Wisconsin cases, the case of *Moors* v. *Drury*[59] is noteworthy, although it does not directly involve a trust receipt. The plaintiff had advanced money for imports and received the bills of lading. The agreement specified that he should sell in his own name and turn over any surplus to the client in this country. The client became insolvent and his estate was under administration in the state court. A Massachusetts statute provided that holders of security, by way of mortgage, pledge or lien, must liquidate such security under the direction of the court if they were to be allowed to prove against the estate for any deficiency. The plaintiff did not do so and objection was made to his claim. The court held that he was not a mortgagee or pledgee within the terms of the statute, and allowed his claim. It relied upon the foregoing decisions. The case is inconsistent with the notion that the banker is a conditional vendor, for it is general law that a retaking and sale by a conditional vendor terminates the contract; that the consideration for the obligation of the vendee thereby fails, and that any deficiency which may result by a sale below the contract price cannot be recovered from the vendee or

[58] See, however, on the question of conflict of laws, *In re Richheimer, supra,* footnote 9.
[59] (1904) 186 Mass. 424, 70 N. E. 430.

his estate.[60] It seems to be unsafe to say that the trust receipt situation is classified in Massachusetts as a conditional sale. It is not, however, such a mortgage as to be included within the scope of statutes relating to "chattel mortgages" of the common sort.[61] In *Irby* v. *Cage, Drew & Co.*,[62] property which had been delivered under trust receipt was retaken from the receiver and sold by the banker for less than the amount of the debt. The receiver claimed that such retaking ended the obligation to pay, as the arrangement constituted a conditional sale. The court held that it was not a conditional sale and that the banker could claim for the deficiency.[63]

The next important case was *Brown Bros.* v. *Billington.*[64] In this decision, the court repudiated the notion that the trust receipt constituted a conditional sale. It defined it as a "bailment" and upheld the rights of the bank as against the general creditors of the importer. The case is interesting because under the law of Pennsylvania the creditors would have prevailed if the court had been persuaded to classify the transaction as either a con-

[60] *Earle* v. *Robinson* (1895) 91 Hun 363, 36 N. Y. Supp. 178, *aff'd* (1898) 157 N. Y. 683, 51 N. E. 1090; *Minneapolis Harvester Works* v. *Hally* (1881) 27 Minn. 495, 8 N. W. 597.
[61] See *Charavay* v. *York Silk Mfg. Co., supra,* footnote 56.
[62] (1908) 121 La. 615, 46 So. 670.
[63] See also *Barber Asphalt Paving Co.* v. *St. Louis Cypress Co.* (1908) 121 La. 152, 46 So. 193.
[64] (1894) 163 Pa. St. 76, 29 Atl. 904; see also *Monjo* v. *French* (1894) 163 Pa. St. 107, 29 Atl. 907; *Bank* v. *Baum* (1898) 187 Pa. St. 48, 40 Atl. 975.

ditional sale[65] or an ordinary chattel mortgage.[66] It is further interesting because resort is had to the common law principle of bailment which gives rise to a common law trust out of which grew the law action of account to which we have already referred.[67] It again shows the readiness of the court to uphold the transaction in spite of the recording acts when that can by any means be done. It would, however, have been impossible to reach the result in this case had the title to the goods come to the bank from the importer instead of from a third person. The vital nature of that distinction—already referred to—is here peculiarly clear.[68]

In 1895, an interesting case, *Blydenstein* v. *New York Sec. & Tr. Co.*,[69] was decided by the Circuit Court of Appeals for the Second Circuit. The particular facts were somewhat involved, but for our present purposes may be briefly summarized. A Scotch firm having a branch house in New York delivered bills of lading of goods, shipped to themselves in New York, to a London banker (the plaintiff) as security for advances. These bills of lading were redelivered to the firm in New York against a trust receipt giving power of sale with the obligation to account for the proceeds. The goods were warehoused in the name of the firm and the negotiable warehouse receipts handed to the defendant as security for a present loan. The firm then failed. The banker claimed from the defendant the proceeds of goods delivered under trust receipt which formed a part of this security. It will be observed that the facts in this case are precisely those of the ordinary unrecorded chattel mortgage where the possession of the goods is returned to the mortgagor. It is not the case where the title of the bank was derived from a person other than the debtor, which is the feature which differentiates the trust receipt situation from the ordinary chattel mortgage.

Had all of the essential events, therefore, taken place within the State of New York, the easy, natural and proper decision would have been to uphold the position of the defendant pledgee upon the ground that the transaction was a chattel mortgage, that it was not followed by delivery to and continued possession of the property by the mortgagee, and was not recorded. It appears, however, that the mortgage was made, and possession of the property as well as title thereto (represented by the bills of lading) was delivered in England where, until recently at least, it seems that a chattel mortgage was valid without recording. Either for this reason or because the true nature of the transaction

[65] *Ott* v. *Sweatman* (1895) 166 Pa. St. 216, 31 Atl. 102.
[66] Pa. Stat. (1920) §§ 8906 *et seq.* A chattel mortgage is an unusual form of security in Pennsylvania.
[67] "Bailment is a recognized form of security in Pennsylvania." *Ditman* v. *Cottrell* (1889) 125 Pa. St. 606, 17 Atl. 504; *Keystone Watch Case Co.* v. *Bank* (1900) 194 Pa. St. 535, 45 Atl. 328.
[68] See also *Richardson & Co.* v. *Nathan* (*Bank's Appeal*) (1895) 167 Pa. St. 513, 31 Atl. 740.
[69] (C. C. A. 1895) 67 Fed. 469.

was not perceived, the decision was based upon the factors' act. It was necessary, if the plaintiff were to succeed, that he should establish that he had acquired title by the transaction in London and that this title had not been lost by delivery under the trust receipt. For the purpose of the case, the court conceded both points and such concession was in accord with the facts so far as the parties themselves were concerned. The plaintiff lost because the defendant was in the position of a bona fide purchaser for value without notice and protected in that position by the factors' act. The court said:[70]

"Assuming that the ownership of the goods passed from Lipman & Co. [the Scotch firm] to the plaintiffs in London and did not pass back by the subsequent transaction, Lipman & Co. were indisputably factors intrusted with the possession both of the documentary evidence of title and of the goods."

It should be noted in this particular case that had the defendant not been in the position of a bona fide purchaser for value, but rather a mere creditor without a specific claim obtained against the goods for value and without notice, the plaintiff would have been successful. But he would have succeeded, not because of his trust receipt as such, but because his rights as chattel mortgagee, valid where obtained, were not subject to the recording acts of New York. It was not a proper case for the use

[70] *Ibid.* 478.

of a trust receipt, if, by the use of such a document, the banker supposed himself to be securing greater protection than he would obtain by taking an unrecorded chattel mortgage.[71]

That the proper field for the use of the trust receipt is not yet generally understood, is shown by a recent case, *In re Carl Dernberg & Sons, Inc.*[72] The facts are quite similar to the *Blydenstein* case. A borrower delivered documents of title to the bank as security for a loan. He later received them back on trust receipt and became bankrupt. The court very properly declined to direct their return by the receiver to the bank. The transaction was an ordinary unrecorded chattel mortgage.[73] The principle of the decision was in no sense new. It was a fundamentally improper case for the use of a trust receipt, and the only surprising thing about it is that it should have been supposed that a trust receipt was of any greater value under the state of facts than an unrecorded chattel mortgage. The trust receipt should not be used when the property is to be returned to the person from whom it was received and for whose obligation it is security. If the property is to be returned under such circumstances,

[71] For another case growing out of the same situation, see *New York Security & Trust Co.* v. *Lipman* (1899) 157 N. Y. 551, 52 N. E. 595. The court declined to consider the nature of the agreement contained in the trust receipt as between the parties to it.

[72] (D. C., S. D. N. Y. 1921) *supra,* footnote 12,* aff'd 282 Fed. 816, see * footnote 12.

[73] See *Moors* v. *Reading* (1897) 167 Mass. 322, 45 N. E. 760; *Skilton* v. *Codington, supra,* footnote 22.

the agreement by which it was mortgaged should be recorded.[74]

National Bank of Deposit v. *Rogers*[75] is an interesting decision which does not impair the force of the foregoing in any way. An importer having goods in bonded warehouse wished to borrow money with which to pay the duty. He showed the bills of lading to the bank (the plaintiff) and obtained a loan upon signing a trust receipt. He then made an assignment for the benefit of creditors. After some earlier litigation, the bank pressed this action in equity to establish an equitable right in the goods and their proceeds (either by way of lien or mortgage) and to enforce the same. The court sustained the claim of the bank as against the assignee. It said that the parties had made an agreement with respect to goods which the importer did not yet control, that as between the parties this agreement was good, and that as the assignee represented antecedent debts, there were no intervening equities which could defeat the rights of the bank. It did not undertake to decide whether this agreement contemplated a mortgage, a pledge or a mere lien by contract. If it were an agreement to give a mortgage, it could

[74] See *In re Gerstman, supra,* footnote 12; *In re Shulman, supra,* footnote 11; *American & British Sec. Co.* v. *American & British Mfg. Co., supra,* footnote 12; *Bell* v. *New York Safety, etc. Co., supra,* footnote 12; *Salinas City Bk.* v. *Graves, supra,* footnote 12; *Fletcher Amer. Nat. Bk.* v. *McDermid, supra,* footnote 12; *Lewis* v. *Bank of Mobile, supra,* footnote 12.

[75] (1901) 166 N. Y. 380, 59 N. E. 922.

hardly have been more effective than an actual mortgage would have been under the circumstances and these circumstances included the fact that the mortgagee did not have possession and that the agreement was not recorded. It is the general rule, however, that an unrecorded chattel mortgage can only be voided by a bona fide purchaser, mortgagee or pledgee for value, or by a creditor armed with a judgment or some other legal process authorizing the seizure of the property. A trustee in bankruptcy is included in this class.[76] Since the assignee for the benefit of antecedent creditors had no better rights than those creditors themselves would have had, the contract was as valid against him as against the importer himself.[77] The case is illustrative of the fact that circumstances may exist under which an unrecorded chattel mortgage is effective. These occasions are, however, rare. The bank succeeded, not because there was any special virtue, in the circumstances, in the use of a trust receipt, for there was none, but because an unrecorded chattel mortgage or an agreement to give a chattel mortgage would have been equally effective in the case. We repeat that it was not a proper occasion for the use of a trust receipt if, by its use, the bank ex-

[76] See *Skilton* v. *Codington, supra,* footnote 22; Federal Bankruptcy Act of 1898 § 70, (1903) 32 Stat. 797, U. S. Comp. Stat. (1916) § 9654; *In re Garcewich* (C. C. A. 1902) 115 Fed. 87 (unrecorded conditional sale).

[77] See discussion in *Bell* v. *New York Safety, etc. Co., supra,* footnote 12; *Wilson* v. *Esten, supra,* footnote 49.

pected to obtain any rights which it could not have secured by an unrecorded chattel mortgage or by an agreement to give security.

The next case of importance in the development of the law of trust receipts was *Moors* v. *Bird.*[78] It indicates that responsibilities as well as rights may grow out of the use of a trust receipt. The defendant had made a contract with the importer for the purchase of paper, the price being based upon the cost of the paper to the importer. Upon the arrival of the goods, the documents were turned over to the importer by the plaintiff (the banker) upon a trust receipt and delivery made to the defendant. The importer handed the invoices to the plaintiff and the defendant made payment direct to him, the plaintiff having no knowledge of the contract of sale between the importer and the defendant. Through a secret arrangement made by the importer, the shipper rebated to the importer a portion of the price which was fictitiously increased without the knowledge of the plaintiff, thus defrauding the defendant. The defendant claimed the right, after discovery, to deduct the amount of this loss from an amount later to be paid to the plaintiff as a result of a later transaction between the same parties, upon the ground that the first overpayment was made as a result of a mistake of fact. The plaintiff had turned over to the importer

[78] (1906) 190 Mass. 400, 77 N. E. 643.

all sums in excess of his advances. His agreement with the importer, however, had given him a right to apply such excess against any debt owing to him by the importer. The court held that the plaintiff was owner of the goods and that the sale was made by him to the defendant in pursuance of the importer's contract; that as the defendant had under mistake paid more than was really due under this contract, he could later reclaim or recoup it from the plaintiff, since the plaintiff was not the importer's agent in receiving payment but had a right to retain the proceeds as such as against the obligations of the importer to him; that the importer had a mere contract right to receive from the plaintiff any surplus that might remain after the payment of his obligations. The result of this case seems open to question. Was not the buyer estopped from recovering the overpayment from the banker who was entirely innocent, because of the change which had taken place in his position after such payment upon his delivery of the balance to the importer?

In re E. Reboulin Fils[79] squarely raised the question of the effect of a trust receipt in a bankruptcy case in the District Court of New Jersey. The bank sought to repossess itself of the goods or their identifiable proceeds from the trustee in bankruptcy. He resisted on the ground that the transaction was

[79] *Supra,* footnote 16.

either a conditional sale or a chattel mortgage within the terms of the recording acts. The court rejected this view and directed the delivery of the goods and their proceeds to the bank. The trust receipt thus obtained explicit recognition in the federal courts in bankruptcy. If, therefore, they constitute a species of chattel mortgage, such species is distinguished from the species ordinarily required to be recorded.

The fiduciary nature of the obligation growing out of the trust receipt was recognized in *In re Coe*.[80] In this case, the bankrupts had misappropriated the proceeds of the goods received by them under trust receipt. It was held that the bank could prove its claim against the estate of the partnership for the amount of the unpaid debt represented by its advances, and that it could also prove claims against the individual estates of the partners founded at its election in tort or quasi-contract, based upon the misappropriation of the bank's property.[81]

This case suggests that the persons responsible for the misappropriation thereby made themselves liable to criminal prosecution for embezzlement or, in those states where by statute this crime is included

[80] (D. C. 1909) 169 Fed. 1002, *aff'd* (C. C. A. 1910) 183 Fed. 745.

[81] *Accord, In re W. S. Kuhn & Co.* (D. C. 1917) 241 Fed. 935; *In re Biehl* (D. C. 1916) 237 Fed. 720; *contra, Schall* v. *Camors* (C. C. A. 1918) 250 Fed. 6; *Reynolds* v. *N. Y. Trust Co.* (C. C. A. 1911) 188 Fed. 611.

in the definition, for larceny. And such a conclusion would appear to be sound.[82] This case is criticised in the Columbia Law Review,[83] but such criticism would not be applicable to a conviction resulting from a trust receipt situation.[84] No instance of a criminal conviction in such a case has, however, come to the writer's notice. Specific statutes have been adopted in at least two states imposing severe penalties for the violation of the obligations of a trust receipt.[85]

During the past fifteen years, substantially all of the litigation with respect to trust receipts has taken place in the federal courts in connection with bankruptcy proceedings or equity receiverships. *Charavay & Bodvin* v. *New York Silk Mfg. Co.*[1] was one of the latter kind. The bank in that case, after a contest in Pennsylvania, recovered all of the goods and their proceeds which could be identified and then presented a claim against the estate for the deficiency. The receiver vigorously contested on the ground that the transaction was a conditional sale and that the retaking had exhausted the bank's rights.[2] The opinion clearly points out the fallacy

[82] See, *e. g., People ex rel. Zotti* v. *Flynn* (1909) 135 App. Div. 276, 120 N. Y. Supp. 511.

[83] (1921) 21 COLUMBIA LAW REV. 517.

[84] On civil arrest also, see *Moffatt* v. *Fulton* (1892) 132 N. Y. 507, 30 N. E. 992.

[85] Md. Gen. Laws art. 27, § 119; La., Laws 1914, No. 9.

[1] (D. C. 1909) 170 Fed. 819.

[2] *Earle* v. *Robinson* (1895) 91 Hun 363, 63 N. Y. Supp. 178, *aff'd* (1898) 157 N. Y. 683, 51 N. E. 1090.

of this position and asserts emphatically that the bank held a security title as collateral to the principal obligation.

A corollary of this last case is presented in *In re Perlhefter*.[3] This is a case of a domestic transaction and while the name trust receipt does not appear, the situation and the agreement used were similar. A trust receipt would have been entirely appropriate. The goods were delivered to the bank under an agreement reserving title, but giving power of sale accompanied by the obligation to turn over the proceeds to the bank until the advance was repaid. These proceeds were turned over to the bank within four months of the filing of the petition in bankruptcy and the question was whether these payments constituted preferences. The court held that they did not. It said very pertinently[4] "it is quite obvious that the contract was in the nature of a mortgage, and not of pledge, for title was reserved to the bank" and pointed out that under the circumstances a chattel mortgage would not have been invalid. This case is interesting because it did not seem necessary to the court to adopt the usual indefinite language regarding the nature of the transaction. Let us follow its reasoning, however, a little further. If the payment of proceeds was not a preference, it must have been because the bank

[3] (D. C. 1910) 177 Fed. 299.
[4] *Ibid.*, p. 303.

had a proprietary interest in such proceeds by which it was entitled to receive them, even as against the creditors of the bankrupt. In other words, if such proceeds had remained in the bankrupt's hands and were identifiable as such, the bank could have reclaimed them from the receiver or trustee. Cases already cited support this conclusion. But had this been the situation, the transaction would have been no less "in the nature of mortgage." In other words, the case is authority for our view that the true trust receipt is a variety of chattel mortgage to which the ordinary rules are held not to apply. The special or exceptional law with respect to a trust receipt is anomalous but is justified for reasons already stated. When we get away from the special facts where a trust receipt can be properly used, we find the ordinary rules applied as to chattel mortgages.[5]

In *In re Cattus*,[6] the Circuit Court of Appeals definitely settled the law of trust receipts in the Second Circuit in accord with the foregoing authorities and permitted the bank to reclaim the property delivered under trust receipt from the trustee in bankruptcy. Its language is decidedly interesting[7]: "The

[5] See *In re Carl Dernberg & Sons, Inc.* (1921) 66 N. Y. L. J. 1200* aff'd 282 Fed. 816, see also *In re Fountain* 282 Fed. 816; *In re Cullen*, 282 Fed. 902; *In re Gerstman* (C. C. A. 1907) 157 Fed. 549; *Copeland* v. *Barnes* (1888) 147 Mass. 388, 18 N. E. 65; *American & British Sec. Co.* v. *A. & B. Mfg. Corp.* (D. C. 1921) 275 Fed. 121; *Bell* v. *New York Safety Steam Power Co.* (D. C. 1910) 183 Fed. 274.
[6] (C. C. A. 1910) 183 Fed. 733.
[7] *Ibid.*, p. 735.

purpose of the parties, describe the trust receipt as you will, was to keep the title to the goods in the bankers until their acceptances for the price of the goods were paid. The courts, without always defining exactly what the relation between the parties is or always defining it in the same way, still are astute to protect the rights of the banker in such case. . . . It would be most inequitable that the bankrupt or his trustee should escape from the performance of this obligation for the benefit of any one except a bona fide purchaser for value or creditors protected by statute." [8]

The law was shortly afterward settled in the Third Circuit by the decision in *Century Throwing Co.* v. *Muller*.[9] The banker had delivered the documents for the raw silk imported to the importer under trust receipt giving power of sale. The importer wished to have it thrown. Throwsters were by statute given a lien for their claims on silk in their hands. They already held thrown silk of the importer upon which they claimed payment and which he wished to release. He consequently delivered the silk in question to the throwsters to be thrown and agreed that they should have a lien upon

[8] In *In re K. Marks & Co.* (C. C. A. 1915) 222 Fed. 53, 56, the court said: "The Trustee contends that these documents and the conduct of the parties constituted a chattel mortgage upon the goods, which was void as to creditors because not filed as required by the Lien Law of New York. He regards the whole thing as a sham. We do not concur in this view at all."

[9] (C. C. A. 1912) 197 Fed. 252.

it for their prior claim in consideration of their releasing the silk already thrown, which they did. They then proceeded to throw the silk delivered under trust receipt (of which they appear to have been ignorant). After the bankruptcy of the importer, the banker tendered the amount due the throwsters for throwing the particular silk, but they refused to deliver, claiming a lien for the prior debt. The banker then sued in trover. The banker had already recovered, by order of the court, such trust receipt silk as was held by the receiver. The language of the court is so illuminative of the accepted view that we shall quote at some length: "The customary character of the transaction is attested, not only by the record before us, but by the judicial notice elicited in many modern cases more or less similar to the present one. . . . The exigencies of trade and commerce have caused many exceptions to be made to the rigid rule founded on the policy underlying the Statute of Frauds, by which the divorce of title from possession is declared either evidence of fraud or to be fraudulent *per se*. . . . The law has long been settled that such title and ownership [of the banker] will be recognized, so far as they are necessary to the security they were intended to give for the payment of the purchase money of the goods bailed, and this, although a dishonest bailee is thereby enabled, by violating his contract of bailment, to avail him-

self of such possession to represent the property as his own and thus practice a fraud on third persons with whom he deals in respect thereto. But such cases are an exception to the ancient rule founded on the policy of the Statute of Frauds. . . . The courts have not attempted to define exactly what the relation between the credit lending banker and the merchant is, as to the goods. . . . It is hardly necessary to add that where, under a contract, delivery of possession without transfer of title or ownership is consistent with the honest and legitimate purpose of the parties to the contract, and where the real owner is not estopped to assert his title by conduct fraudulent or otherwise, his title cannot be divested by anything done by the one in possession, in fraud of or inconsistent with such contract." And the court adds, by way of establishing the anomaly: "We find no ground upon which we can hold that the transaction here in question was tantamount to a mortgage, equitable or otherwise." Judgment for the banker was affirmed.[10]

[10] *Ibid.* 258 *et seq.* This case was followed by *Roth* v. *Smith* (C. C. A. 1914) 215 Fed. 82, reported below *sub nom, In re Killian Mfg. Co.* (D. C. 1913) 209 Fed. 498. The principle is also established in the 1st Circuit. See *Brown* v. *Mass. Hide Corp.* (C. C. A. 1915) 218 Fed. 769, reversing 209 Fed. 667; see also *Ludvigh* v. *American Woolen Co.* (1913) 231 U. S. 522, 34 Sup. Ct. 161, a case which strongly indicates the support of the Supreme Court; see *In re Wright-Dana Hardware Co.* (C. C. A. 1914) 211 Fed. 908.* See also *Chemical National Bank* v. *New York Dock Co.* 203 App. Div. 108 (1922).

As a recognition of the general doctrine, the *Century Throwing* case is very strong. Let us now look at some of its implications. A release of property held in pledge or subject to lien in consideration of a delivery of other property to be held subject to the same lien has uniformly been held to be present consideration for such lien or pledge.[11] It matters not that the first pledge or lien existed by statute—the second pledge by contract makes the property subject to the same lien which formerly covered the first. It must be said, therefore, that the throwsters were bona fide pledgees for value of the imported silk as security for their earlier debt. The decision, therefore, means that in New Jersey at least a person entrusted with a power to sell (we may call him a factor) cannot make a valid pledge or mortgage. Such is the general rule, not only in New Jersey, but elsewhere, in the absence of a factors' act or special legislation.[12] In other words, if the importer had pledged the property with another bank by delivery of the silk, or (in the absence of the Bills of Lading Act) of the bill of lading therefor, as security for a present loan, such bank would have been unsuccessful in retaining the goods as against the claim of the banker who held the trust receipt. We may inquire, therefore, why the banker

[11] *Blydenstein* v. *New York Sec. & Tr. Co.* (C. C. A. 1895) 67 Fed. 469.

[12] *Towne* v. *Goldman* (1902) 26 N. J. L. J. 47; see also citations in (1921) 25 C. J. 351.

in this case tendered to the throwsters the amount of their bill for throwing the particular silk. The answer is doubtless to be found either in the New Jersey Statute giving throwsters of silk a lien for the value of their service or in a quasi-contractual obligation based on the enhancement in value due to the throwsters' service.

V

FACTORS' ACT: It is, as we have said, the common law rule that a factor for sale cannot make a valid pledge. This rule has, however, in New York and Massachusetts been modified by factors' acts.[13] The decision last discussed should, therefore, have been otherwise, had the case arisen under the law of New York or of Massachusetts (or in England where, however, the trust receipt is not in common use although it is sometimes used under the name of "Letter of Lien" or a similar title).[14] Unless, therefore, a similar modification of the common law rule is effected by some other piece of legislation—a question which we shall immediately consider—it may be said that the protection afforded by a trust receipt is somewhat less in New York and Massachusetts than in other states by reason of the fact that the factors' acts in those two states uphold a

[13] N. Y. Pers. Prop. Law, § 43, first enacted in 1830, Massachusetts Acts 1845, c. 193; these are, of course, based upon the earlier English Act (1823) 4 George IV., c. 83.

[14] See *Blydenstein* v. *New York Sec. & Tr. Co., supra,* footnote 11.

bona fide pledgee or mortgagee as against the banker who holds the trust receipt, whereas in other states such bona fide pledgee or mortgagee acquires no rights as against the holder of the trust receipt. In this connection, it will be recalled that we have already referred to Ohio, Illinois and a few other states, with special reference to the form and effect of the recording acts in those states.[15]

UNIFORM CONDITIONAL SALES ACT: "§ 1. In this Act 'Conditional Sale' means (1) any contract for the sale of goods under which possession is delivered to the buyer and the property in the goods is to vest in the buyer at a subsequent time upon the payment of part or all of the price, or upon the performance of any other condition or the happening of any contingency; or (2) any contract for the bailment or leasing of goods by which the bailee or lessee contracts to pay as compensation a sum substantially equivalent to the value of the goods, and by which it is agreed that the bailee or lessee is bound to become, or has the option of becoming the owner of such goods upon full compliance with the terms of the contract." From what has already been said about the trust receipt in relation to conditional sales, it is clear that it does not come within the

[15] But a promise by the signer of the trust receipt given to another lender, to repay him out of the proceeds of trust receipt property, is not enforceable as against the holder of the trust receipt. *Munroe* v. *Bonanno* (1893) 31 Abb. N. C. 1, 28 N. Y. Supp. 375.

first part of this definition. As to the second part, the same is equally clear if it be noted that the payment must be "as compensation" for the goods. This statute, therefore, has no bearing on trust receipts except as it may be adopted in a jurisdiction like Connecticut which has judicially defined the trust receipt as a conditional sale. As yet it has not been adopted in any such jurisdiction. If it should be so adopted, we may anticipate that the court will find a way to bring its decisions regarding trust receipts into line with the general current of authority.

UNIFORM BILLS OF LADING ACT: This has been adopted in more than twenty jurisdictions. Among its provisions are the following:

"§31. A negotiable bill may be negotiated by any person in possession of the same, however such possession may have been acquired if, by the terms of the bill, the carrier undertakes to deliver the goods to the order of such person, or if at the time of negotiation, the bill is in such form that it may be negotiated by delivery." [16]

"§32. A person to whom a negotiable bill has been duly negotiated acquires thereby: (a) Such title to the goods as the person negotiating the bill to him had or had ability to convey to a purchaser in good faith for value and also such title to the

[16] *E. g.*, if it is endorsed in blank—see § 29.

goods as the consignee and consignor had or had power to convey to a purchaser in good faith for value. . . . "

"§53. . . . 'Purchaser' includes mortgagee and pledgee. 'Value' is any consideration sufficient to support a simple contract. An antecedent or pre-existing obligation, whether for money or not, constitutes value where a bill is taken either in satisfaction thereof or as security therefor." [17]

This Act obviously accomplishes the results of the factors' act in so far as bills of lading are concerned in states which hitherto have had no factors' act. It would not, however, had it been the law in New Jersey at the time, have affected the result in *Century Throwing Co.* v. *Muller*,[18] since a bill of lading was not involved in that case. It, however, goes farther than the factors' act by including a pre-existing obligation as "value." The result is that if a banker endorses and delivers a negotiable bill of lading to the importer upon any sort of trust receipt, whether it be limited to an entry of the goods in the custom house, to warehousing, or whether it broadly gives the right to manufacture and sell, he puts it in the power of the importer to mortgage, pledge or sell the bill of lading or to deliver it in payment of or as security for an exist-

[17] See also §§ 38, 39. This definition of "value" has not been adopted in New York in its enactment of the Bills of Lading Act. N. Y. Pers. Prop. Law § 239.

[18] *Supra*, footnote 9.

ing obligation. He cannot recover it from any such transferee in good faith. Obviously this considerably impairs the security of the banker in dealing with bills of lading.[19] The banker can doubtless still recover the bill of lading from the importer or his receiver or trustee. The Act, of course, ceases to be pertinent as soon as the bill of lading is spent, as it does not affect transfers otherwise than by means of the document. It also has no effect in cases where non-negotiable bills of lading are used.

UNIFORM WAREHOUSE RECEIPTS ACT: This Act has been adopted in more than forty jurisdictions. Its provisions are similar to those quoted above in connection with the Bills of Lading Act, and its definition of "value" is the same.[20] In fact, the legal effect of these two statutes is to give to bills of lading and warehouse receipts the quality of negotiable instruments, which they have long possessed in practice to a much more limited extent. This has the necessary effect of making the possession of the document, when combined with its form and apparent ownership, the all-important fact. It is now possible for a dishonest bailee of goods represented by these negotiable documents of title, to cause injuries to his principal or bailor by negotiating the documents when he could not cause such injury by the delivery of the goods themselves. The documents may be transferred effectively in ways that would be quite ineffective if employed with reference to the goods themselves. The documents are, therefore, more than mere representatives of the goods. For example, in New York a factor cannot pledge the goods themselves as security for an antecedent obligation, but he can do so if he delivers a negotiable warehouse receipt therefor which is regular on its face. On the other hand, a thief cannot, by obtaining a bill of lading or warehouse receipt for the stolen goods, thereby enable an honest purchaser to retain them as against the true owner.[21]

An interesting decision in connection with this statute is *In re Richheimer*,[22] already referred to in connection with the recording acts. Imported coffee was delivered under a trust receipt. The

[19] See Williston, *Sales* (1909) § 437; see also *Roland M. Baker Co.* v. *Brown* (1913) 214 Mass. 196, 100 N. E. 1025. In that case, the defendant (the banker) indorsed and delivered the bill of lading to the Massachusetts Hide Co. against a trust receipt. That concern wrongfully transferred the bill of lading to the Columbia Co. in payment of an existing obligation. The Columbia Co. acted in good faith. It later transferred the bill of lading to the plaintiff, who is assumed to have had knowledge of defendant's claim under the trust receipt. The court held that, as the Columbia Co. obtained full title, the knowledge of the plaintiff was not material and it upheld the rights of the plaintiff to the goods as against the defendant banker.

[20] See §§ 37-43, 47, 48, 58.

[21] *Commercial Bank* v. *Canal Bank* (1916) 239 U. S. 520, 525-26, 36 Sup. Ct. 194, *infra; Mechanics & T. Bk.* v. *F. & M. Bk.* (1875) 60 N. Y. 40; *Farmers & M. Bk.* v. *Atkinson* (1878) 74 N. Y. 587; *Hentz* v. *Miller* (1883) 94 N. Y. 65; *Thacher* v. *Moors* (1883) 134 Mass. 156; *Soltau* v. *Gerdau* (1890) 119 N. Y. 380; Williston, *op. cit.* § 421.

[22] (C. C. A. 1915) 221 Fed. 16.

importer placed most of it in warehouse and pledged the negotiable warehouse receipts as security for present loans. There is no factors' act in Illinois where the case arose. The court decided against the banker holding the trust receipt. The decision appears to rest as to a large part of the goods upon the Warehouse Receipts Act. If so, the question arises whether the importer was authorized to place the coffee in warehouse and to take negotiable receipts therefor and whether by so doing he could put the banker in a worse position than he occupied when he delivered the goods. But further examination indicates that the Warehouse Receipts Act was not necessary to the decision. It appears that seven bags of coffee were still in the importer's hands against which no warehouse receipt had been issued. The court refused to return these to the banker, and held that the trust receipt was invalid in Illinois as being contrary to its public policy and the Recording Act. This is the key to the decision. It follows that the banker could not recover any of the coffee and consequently that the taking of the warehouse receipts and the pledge of these documents did him no additional injury. He could not have recovered the coffee, even if it had remained in the hands of the importer. The question of the importer's authority to warehouse the goods and to take negotiable warehouse receipts to

his own order, therefore, is not necessarily answered by this decision.[23]

Another important decision is *Commercial Bank* v. *Canal Bank*,[24] reversing *In re Dreuil & Co.*[25] In this case, the bankrupt having already received bills of lading, pledged them to the Canal Bank. In Louisiana a pledge carries title; the transaction, therefore, amounted to a chattel mortgage. It should be noted at the outset that the facts are not such as lay the foundation for the distinctive doctrine of the trust receipt under principles already pointed out, since the title did not pass to the bank from a third person but directly from the debtor. This fact was not apparently noted by the court. The Canal Bank, however, returned the bills of lading against a trust receipt giving power of sale and also power to warehouse the goods. The bankrupt then warehoused the goods (cotton) after having had it picked, and took negotiable warehouse receipts to its own order which it pledged to the Commercial Bank. It later again withdrew the warehouse receipts against a similar trust receipt. It then withdrew the goods which, upon the bankruptcy, passed into the possession of the trustee. The question is not whether the trustee can retain

[23] The trust receipt in this case was delivered in Louisiana and the bankers contended that the transaction was governed by the law of that state. See *Mershon* v. *Moors* (1890) 76 Wis. 502, 45 N. W. 95. The court, however, rejected this contention.

[24] *Supra*, footnote 21.

[25] (C. C. A. 1914) 211 Fed. 337; (D. C. 1913) 205 Fed. 568.

the property as part of the estate,—the court concedes that he cannot,—(that in Louisiana the holder of a trust receipt would be protected as against the trustee in bankruptcy seems to be settled by *In re Dreuil & Co.*)[26] it is rather as to which bank is entitled thereto.[27]

It is clear that had the bankrupt re-pledged the bills of lading to the Commercial Bank after receiving them against a trust receipt from the Canal Bank, the former would have been protected. The court found that the bankrupt was authorized by the Canal Bank to take negotiable warehouse receipts for the goods which it would hold subject to the same obligations which covered the bills of lading and that, while the negotiation of these receipts constituted a wrong on the part of the bankrupt toward the Canal Bank, nevertheless, the bona fide pledgee (the Commercial Bank) acquired thereby a valid title in accordance with the provisions of the Warehouse Receipts Act. It, therefore, awarded possession of the goods to the second pledgee. This conclusion is inevitable from the facts found and is the same as would have resulted had the bills

[26] *Supra,* footnote 25; see *The Trust Receipt as Security, I.* (1922) 22 COLUMBIA LAW REV. 395, 408, for a discussion of this case.

[27] The court goes farther than is necessary on this point being influenced either by the admission of the trustee or the fact that in Louisiana an ordinary chattel mortgagee (pledgee) would, under even these circumstances, be protected. The trust receipt cases cited in the opinion do not go to the extent claimed by the court, since they relate to the peculiar trust receipt situation which did not exist in this case. *Cf. In re Carl Dernberg & Sons, Inc., supra,* footnote 5; *In re Gerstman, supra,* footnote 5; *In re Shulman* (D. C. 1913) 206 Fed. 129.

of lading themselves been re-pledged. The lower court appears to have decided otherwise upon the ground that the bankrupt had no authority to take a negotiable warehouse receipt to his own order. A careful reading of the agreement involved seems to leave it open to question whether it was not the duty of the bankrupt to store the goods in the name of the Canal Bank and consequently whether the Supreme Court was correct in finding that the taking of negotiable warehouse receipts to the order of the bankrupt was authorized. The agreement made it the duty of the bankrupt to deliver any warehouse receipt to the bank within one day after receipt and apparently limited its right to the receipt of any document of title "for account of the said bank." If the trust receipt had expressly provided that any warehouse receipts should be taken in the name of the bank, the case before the Supreme Court would have presented a different question, namely, the one which we have already raised.

Let us look at it from the standpoint of principle. Suppose, in a proper trust receipt case, the goods themselves are delivered to the importer with power to sell to a named buyer, who is represented as being ready at once to take under a contract already made. In this case, a warehousing would seem to be outside the contemplation of the parties. The taking of a negotiable warehouse receipt to the order of

the importer would, therefore, seem to amount to a conversion of the property. The result should be that a pledgee of such warehouse receipt would not acquire any greater rights by reason of receiving such document than he would have acquired by the pledge of the goods themselves.[28]

If, on the other hand, the trust receipt gave merely the power to sell generally, it might be argued that in the meantime storage must be contemplated as a reasonable incident. Even so, it is not at all necessary that a negotiable warehouse receipt should be obtained and, in view of the fact that the risks of the bank are increased by the issue of such a document, it would seem improper for the importer to do so without the express consent of the banker. The same may be said of a trust receipt giving express power to warehouse. In view, however, of the opinion last commented upon, it seems probable that when the question is squarely presented, the holding will be that, if the power to warehouse is expressed or implied, the taking of a negotiable receipt in the name of the importer will not be held to be a breach of duty on his part. The consequence will be, as decided by the Supreme Court, that a bona fide pledgee or mortgagee of this warehouse receipt, whether for a present or past consideration, will acquire a good title. A purchaser as such will, of course, be protected.

[28] See *Mechanics & T. Bk.* v. *F. & M. Bk., supra,* footnote 21.

For the protection of the banker, therefore, the trust receipt should, in view of the Warehouse Receipts Act and this decision, contain an express provision that in case of warehousing, all receipts must be issued in the name of and immediately delivered to the banker or his agent. If this is inconvenient, it should at least be provided that only non-negotiable receipts be taken by the importer. These provisions will not, of course, afford any protection as against the factors' act; but, apart from that act, it would seem that the taking of a negotiable warehouse receipt by the importer in the face of such a provision of the trust receipt would be tortious and that a pledgee or mortgagee thereof would fall without the scope and protection of the Warehouse Receipts Act.[29]

VI

The problem of identifying the goods or of tracing their proceeds is an important and sometimes a difficult one. In certain aspects, it is distinct from the questions which we have already considered. It might be argued since the property of the claimant has gone to the general enrichment of the estate of the holder, who has converted it, that the claimant should be allowed an equivalent amount in preference to general creditors. Such a view has at times been taken in various jurisdictions, but is opposed

[29] *Moors* v. *Kidder* (1887) 106 N. Y. 32, 12 N. E. 818; *Mechanics & T. Bk.* v. *F. & M. Bk., supra,* footnote 21.

to the great weight of authority.[30] It is undoubtedly the general rule that the burden of tracing the fund or property into the property claimed rests with the beneficiary who claims it.[31] It is obviously impossible to consider the problem of tracing the goods in every form in which that question may be raised. We will, however, consider a number of hypothetical situations.

(a) The question often arises with respect to the proceeds of property sold under the power of sale contained in the trust receipt. Suppose the purchase price has not yet been collected from the purchaser. This account receivable is clearly the proceeds of the trust receipt property. The banker may notify the buyer of his rights and collect such account from the buyer, just as he could retake the proceeds from the signer of the trust receipt. If the buyer fails or refuses to recognize or protect the banker's rights, he becomes directly liable to him for any loss caused thereby.[32] A buyer, however, who purchases from a signer of a trust receipt will be protected if he has paid the purchase money

[30] See discussion in *In re Mulligan* (D. C. 1902) 116 Fed. 715, 717; also 39 Cyc. 530 *et seq.*

[31] *Litchfield* v. *Ballou* (1885) 114 U. S. 190, 5 Sup. Ct. 820.

[32] *Thayer* v. *Dwight* (1870) 104 Mass. 254; *Dows* v. *Kidder* (1881) 84 N. Y. 121; *Assets Realization Co.* v. *Sovereign Bk. of Canada* (C. C. A. 1914) 210 Fed. 156; *First Nat. Bk. of Cincinnati* v. *Kelly* (1874) 57 N. Y. 34; *First Nat. Bk. of Auburn* v. *Eastern Tr. & Banking Co.* (1911) 108 Me. 79, 79 Atl. 4. The last case is interesting because it was that of an ordinary chattel mortgage which does not appear to have been recorded. The trustee in bankruptcy made no claims to the proceeds of the mortgaged property. If he had done so, it would seem that he would have been successful under principles and authorities already discussed.

to him.[33] This account receivable may, however, have been pledged, mortgaged or assigned by the signer of the trust receipt. Such a pledge or mortgage of a chose in action is not subject to the recording acts. It is not, however, within the protection of the factors' act and it is the general rule that the assignee of a chose in action takes subject to all existing equities. Since the signer of the trust receipt was a trustee of this account for the benefit of the holder of the trust receipt, the pledgee, mortgagee or assignee of the account would fail in a claim thereto as against the holder of the trust receipt.

(b) Suppose the signer of the trust receipt has collected the purchase price and instead of immediately delivering it to the banker, has deposited it in his own bank account,[34] in which he continues to make deposits and from which he pays out by check or otherwise. Obviously, the identity of the money is lost. Nor is it exactly like a mingling of fungible goods, for the depository owes a debt therefor instead of holding a sum of money belonging to the depositor. Nevertheless, it has a certain resemblance to a mingling of fungible goods. Any rules regarding the identity of the funds used from time to time are largely arbitrary—mere presumptions. They are, nevertheless, well recognized. What is

[33] *Brown Bros. & Co.* v. *William Clark Co.* (1900) 22 R. I. 36, 46 Atl. 239.

[34] *English Bank* v. *Barr* (N. Y. 1888) 31 Abb. N. C. 7.

known as the rule in *Clayton's Case* [35] holds that in an ordinary bank account, money is presumed to have been withdrawn in the order in which it was deposited. This, however, is held not to apply to a case where a fiduciary or trustee has mingled his own funds with funds belonging to the trust estate. He can hardly be heard to say that he has wrongfully used trust funds so long as his own funds were equally available. It is consequently the rule in such cases that he is presumed to have used his own funds in preference to trust funds.[36] This is the rule with respect to the proceeds of trust receipt property.[37]

(c) Suppose, however, the signer of the trust receipt has also deposited in the bank account the proceeds of other goods covered by trust receipts held by other parties and has withdrawn so much of the deposit that insufficient remains to satisfy the claims of all holders of trust receipts. It is obviously unfair to say that he shall be presumed to have withdrawn the property of one trust receipt holder in preference to that of another. Two courses are possible—either to divide the fund proportionately, or according to the rule in *Clayton's Case*.[38] A proportionate division seems more just; but this presupposes the possibility of determining

[35] (1816) 1 Mer. 572.
[36] *In re Hallets Estate* (1879) 13 Ch. Div. 696.
[37] *In re Mulligan, supra,* footnote 30.
[38] *In re Mulligan, supra,* footnote 30.

the proportions, which in turn requires the determination of the amounts belonging to each holder of trust receipts which have gone into the fund. This is sometimes impossible. No definite rule has as yet been adopted covering this situation.[39] But the tendency is to support a proportionate distribution. The rule of *Clayton's Case* rests upon a mere presumption which is highly unsatisfactory in the circumstances. It is unfair to presume that there was an intention of wronging one beneficiary rather than the other. The only reasonable view is that the wrong should be taken to have been inflicted ratably on each and that any unconverted balance should be turned over to them in proportion to their original interests.*

(d) Suppose the balance of the account is claimed by the bank in which it is deposited, in whole or in part, under a lien created either by contract or by what is known as a banker's lien, which is really a right of set-off. If the bank has already applied any portion of the deposit toward the payment of a claim which is due without knowledge of the claim of the holder of the trust receipt, it has been held that such application is equivalent to a payment by the depositor out of the fund.[40] The

[39] *In re Mulligan, supra,* footnote 30; *Litchfield* v. *Ballou, supra,* footnote 31.
[40] *Meyers* v. *New York Co. Nat. Bk.* (1899) 36 App. Div. 482, 55 N. Y. Supp. 504; *London & River Plate Bk.* v. *Hanover Nat. Bk.* (1899) 36 App. Div. 487, 55 N. Y. Supp. 941. This was a trust receipt case, although that fact does not appear from the decision. *School District* v. *First Nat. Bk.* (1869) 102 Mass. 174.
* An interesting note on this point will be found in 23 Columbia Law Review, p. 567.

general banker's lien applies only to accounts which are already due and payable.[41] It is held further that a depositor may by contract give the bank a lien upon the deposit for the payment of obligations not yet due,[42] and that an application by the bank when any such obligation is due is equivalent to payment by the depositor. Whether such lien is effective as against the holder of the trust receipt before application is actually made is another question. It should apparently be determined on the analogy of rules relating to collateral security. As to obligations incurred coincident with or subsequent to the deposit, and in reliance thereon, it should everywhere be held that the lien of the bank is superior to the rights of the holder of the trust receipt. Where, however, the lien is claimed as security for an existing obligation, it should prevail as against a holder of a trust receipt only if a pledge of the goods themselves as security for a past obligation (whether as yet due or not) would be upheld.[43]

Where, however, the deposit is made with knowledge on the part of the bank that the money in fact belongs to the holder of a trust receipt, it should be treated as a special deposit, since in that case the bank is not a bona fide taker.[44]

[41] *Jordan* v. *National Shoe & Leather Bk.* (1878) 74 N. Y. 467.
[42] *Meyers* v. *New York Co. Nat. Bk., supra,* footnote 40; *Hatch* v. *National Bk.* (1895) 147 N. Y. 184, 41 N. E. 403.
[43] *Drexel* v. *Pease* (1892) 133 N. Y. 129, 30 N. E. 732.
[44] *Lowery* v. *Steward* (1862) 25 N. Y. 239; *Heidelbach* v. *National Park Bk.* (1895) 87 Hun 117, 33 N. Y. Supp. 794. The signer of

If knowledge of the rights of the holder of the trust receipt came to the bank at a time subsequent to the deposit where it is already claiming its lien under proper circumstances, the acquisition of such knowledge cannot impair its rights, since its equitable position has already been established.[45] It would be unsafe, however, to say with respect to the position of the bank that the right to make application of the deposit to the payment of a debt is in law equivalent to its having made such application in fact. For example—application is payment and the bank may retain the funds actually received in payment as against a *cestui que trust* of whose interest it was ignorant. But, prior to application, the bank is in the position of a holder of security and if such security was given for an existing debt, the bank cannot retain it as against the *cestui que trust* after notice of his right, nor can it thereafter make application (*i. e.,* take payment) out of such trust funds. In other words, actual application ends the matter, but prior to such application, notice received of the rights of third persons may, in certain circumstances, deprive the bank of its right to make application.

the trust receipt who has received the money proceeds of a sale appears to be a genuine trustee of such money for the benefit of the holder of the trust receipt and the principles relating to tracing trust funds are entirely applicable to the situation. *First Nat. Bk. of Auburn* v. *Eastern Tr. & Banking Co., supra,* footnote 32.

[45] See, however, *Meyers* v. *New York Co. Nat. Bk., supra,* footnote 40, p. 485.

(e) Suppose, now, that the proceeds of trust receipt property have been invested by the signer of the trust receipt in other property. Undoubtedly such proceeds may be retaken by the holder of the trust receipt, provided they can be traced and identified and no superior equities have intervened. The problem, however, often presents great practical difficulties, as appears from the case of *In re Mulligan.*[46] The proceeds of trust receipt property to the extent of $4,000 were paid to stockbrokers for the credit of the signer of the trust receipt in a current and running account, apparently involving frequent transactions. Later the customer became bankrupt and, after paying off the claim of the broker, the securities remaining were found to have a value of $1,100. This was claimed as the proceeds of the trust receipt property. There was no evidence as to the state of the account between the time when the $4,000 was paid in and the end. Consequently, if the analogy of a bank account and the rule of *Hallett's* case[47] had been applied, the claimant would have failed for want of proof. The court, however, expressed the view rather strongly that this principle did not apply in cases other than bank accounts. "The priority . . . which has sometimes been given to the *cestui* in the application of the cash assets of a bank which has mingled

[46] *Supra,* footnote 37.
[47] *Supra,* footnote 36.

the trust fund with its own funds, whether defensible or not, is limited to the case of the cash assets of a bank, and is not extended to other kinds of defaulting trustees or to other assets of the bank. . . . This is not the case of a bank account, which, as has been said, is affected by a rather artificial rule." [48]

So far as the estate of the signer of the trust receipt is concerned, this is doubtless sound. Any other rule would result in giving to the holder of the trust receipt in effect a priority out of the general assets without regard to the identification of the property or its proceeds.[49] If, however, the signer of the trust receipt had, for example, received cash in payment and had placed this in his cash box, and if it were shown that from that time there had always been at least that amount in the cash box, would it not be reasonable to apply the analogy of the bank account to the case and to deliver the amount to the holder of the trust receipt? Or, if the contents of the cash box had at times fallen below the sum, would it not be fair to say that the trust fund had been depleted only in part and that the holder of the trust receipt was entitled to the balance? In such cases, the rule of *Hallett's* case is equitable and there seems no reason for restricting its operation to banks or bank accounts.

[48] *Supra,* footnote 37, p. 719.
[49] *In re K. Marks & Co., supra,* footnote 8.

(f) Suppose that the signer of the trust receipt has altered the form, appearance or value of the property by the application of labor, but without the addition of any other materials. This situation existed in the case of *In re Dreuil & Co.*,[50] where 100 bales of cotton were put through a "pickery" and turned into 150 bales of cotton. There can be no doubt that the holder of the trust receipt retains his rights in the goods as long as they can be identified and that labor spent upon them by the signer of the trust receipt is without effect of any sort in the way of impairing the rights of the holder of the trust receipt, whether the labor results in an increase or decrease of value. On the other hand, if an outsider is employed to do the work, he may in many cases obtain a superior lien upon the goods for the value of his services.[51]

(g) Suppose that the goods are altered in form, appearance or value, by the addition of other materials as well as by labor. This is the most common form of manufacture. In so far as the added materials come from the property of the signer of the trust receipt, they are mere accretions and the resultant product, if identifiable, is still the property of the holder of the trust receipt. If such new material and labor are supplied by an outsider,

[50] *Supra*, footnote 25.
[51] See *Century Throwing Co.* v. *Muller*, *supra*, footnote 9; *Barry* v. *Boniger* (1877) 46 Md. 59.

he may have a superior lien for their value, after the satisfaction of which the holder of the trust receipt may reclaim the goods in their manufactured state.[52]

(h) Suppose the manufactured product is composed of material obtained against a trust receipt, held by A, and of other material obtained against a trust receipt held by B, combined with labor supplied by the signer of the trust receipt. It would seem to be clear that A and B are co-owners (not joint owners) of the product and that they may divide the product between them in proportion as their respective goods have gone into this resultant. It may happen, however, that the contribution made by one of them cannot be ascertained satisfactorily or is not capable of division.[53] In that case, it would seem to be impossible to allot any part to either of them. This situation is analogous to that presented by the second case covered by *In re Mulligan*.[54] It may, however, sometimes be possible to allot a share to A, based on his known contribution and upon a computation of the maximum contribution conceivable to have been made by B.

(i) Suppose the goods obtained under trust receipt are fungible and have been mixed with other goods belonging to the signer of the trust receipt.

[52] *Brown* v. *Mass. Hide Corp.*, *supra*, footnote 10.
[53] See *Litchfield* v. *Ballou*, *supra*, footnote 31.
[54] *Supra*, footnote 37.

May we not apply the analogy of a bank account and hold that, as this mass has been consumed by the signer of the trust receipt, he will be held to have misappropriated the goods of the holder of the trust receipt, only when and to the extent that such a conclusion is made necessary by the facts? In other words, may he not be presumed to have used his own goods so long as he owned any share of the combined mass? Such a rule commends itself as equitable, but only to the extent that the use made of the goods by the signer of the trust receipt has been inconsistent with his obligations thereunder.[55]

(j) Suppose fungible goods obtained from A against trust receipt are mingled with similar goods similarly obtained from B. They appear clearly to be co-owners of the mass in proportion to their respective contributions. The problem here seems to be very similar to those considered under (c) and (h).[56]

A bond or insurance is sometimes taken to secure the faithful performance of the obligations of the signer of the trust receipt. It is hardly necessary to remark that the assured must show a strict compliance on his own part with the terms of the trust receipt.[57]

[55] See *Peoples Nat. Bk.* v. *Mulholland* (1917) 228 Mass. 152, 117 N. E. 46; *Blydenstein* v. *New York Sec. & Tr. Co., supra,* footnote 11; *New York Sec. & Tr. Co.* v. *Lipman* (1899) 157 N. Y. 551, 52 N. E. 595.

[56] See *Blydenstein* v. *New York Sec. & Tr. Co., supra,* footnote 11.

[57] *Tradesmen's Nat. Bk.* v. *National Surety Co.* (1902) 169 N. Y. 563, 62 N. E. 670.

A great part of the difficulty which bankers have experienced in connection with trust receipts has been due to the failure on the part of the banker to follow the transaction or to make sure that the signer of the trust receipt lives up to his part of the arrangement. This, of course, involves trouble, but so long as bankers are content to rely on the honesty and good faith of their customers in this regard, they can hardly expect to avoid substantial losses through the failure of such customers to scrupulously live up to such obligations. Such failure is as often due to the fact that the customer does not understand those obligations as it is to wilful wrongdoing on his part.

VII

CONCLUSIONS.

(1) The only situation in which a trust receipt may properly be used is one in which the title of property by way of security is conveyed to the creditor by an owner who is not the person responsible for the satisfaction of the obligation which the property secures* but where such obligor has a contractual or beneficial interest in the property subject to the satisfaction of such obligation. The creditor may then deliver the property to the obligor who has hitherto had neither title thereto nor possession thereof, against an appropriate trust receipt.

* Quoted *In re Cullen,* 282 Fed. 902 (D. C. Md. 1922.)

The rights of the creditor in the property will be protected to the extent of the special trust receipt doctrine. In practice, the trust receipt situation exists only in connection with advances for the purchase of goods by way of the payment of drafts against bill of lading.

(2) The trust receipt should never be used in connection with the redelivery of property pledged or mortgaged by the person signing the trust receipt.

(3) In the proper trust receipt situation, the creditor, generally a bank or banker, has legal title to the property for the purpose of security. This creditor is a mortgagee and the arrangement is a chattel mortgage, but of a peculiar type, distinguishable from the usual chattel mortgage by reason of the fact that the obligor has not prior to the arrangement had either title to or possession of the property mortgaged.

(4) Except in Ohio, Illinois, and perhaps South Carolina and Virginia, cases so far decided hold that the trust receipt does not come within the provisions of the recording acts respecting chattel mortgages or conditional sales.

(5) In New York and Massachusetts, where the factors' act is in force, a bona fide mortgagee or pledgee for present value obtains from the signer of

the trust receipt a right superior to the title of the creditor who holds the trust receipt.

(6) The adoption of the Uniform Bills of Lading Act and the Warehouse Receipts Act by various states has given to those instruments in large degree the qualities of negotiable instruments. These laws accomplish the results of the factors' act. In those states which have adopted the definition of "value" as recommended by the Committee on Uniform Legislation, an antecedent debt constitutes value, and a bona fide purchaser, pledgee or mortgagee of such a document, regular on its face and from one to whom it has been entrusted by the holder of the trust receipt, obtains a title superior to the rights of the holder of the trust receipt.

(7) If goods themselves are entrusted under trust receipt, appropriate language should be used to negative any presumption of right in the signer to take negotiable warehouse receipts to his own order.

(8) Except as noted in (4), property delivered to the signer of a trust receipt under circumstances suitable for the use of such an instrument may, if identified, be retaken from the signer at any time before the satisfaction of the obligation secured by the property. It may also be retaken from his receiver, assignee, trustee in bankruptcy or an attach-

ing creditor. Its proceeds may likewise be retaken, provided they can be identified.

(9) The unpaid purchase price of property delivered to the signer against his trust receipt and by him sold to a bona fide purchaser may be recovered by the holder of the trust receipt directly from such buyer.

(10) The property delivered in a proper case against trust receipt may be recovered by the holder of the trust receipt, prior to payment of the obligation secured thereby, from any person to whom the signer has delivered the same, unless such right of recovery is cut off by the exercise of a power of sale, express or implied, or statutory provisions which include a bona fide pledge or mortgage within the scope of such power.

(11) The trust receipt cannot assure to the holder thereof any rights beyond those which he would have had as the holder of an unrecorded chattel mortgage, an equitable pledge or mortgage, or a simple contract, if it is used in any case other than that which has been defined as a proper trust receipt case.

(12) The benefit of the trust receipt doctrine is not dependent upon any special virtue in the name or the precise form or appearance of the agreement. If the agreement can in substance be shown to have

been clearly made between the parties in a proper case, the legal results will follow, even though resort is had to the original credit agreement for the purpose of establishing the existence of the security arrangement.

KARL T. FREDERICK.

NEW YORK CITY.

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